State Budget
Proposal for Fiscal Years 2013-2014

Major Provisions of the Budget
and Multi-Year Budget Plan

Jerusalem June 2013

To the Reader,

This booklet summarizes the major provisions of the budget proposal for the fiscal years of 2013-2014. Additional material on government activities related to the 2013-2014 budget is available in the detailed booklets of this budget proposal (Hebrew).

The binding and the full version of the following proposal is the Hebrew version as published by the Ministry of Finance:

http://mof.gov.il/BudgetSite/StateBudget/Budget2013_2014/Pages/Budget2013_2014HP.aspx

The following translation is submitted for general knowledge purposes.

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Definitions

1. In this Law:

"**Budget Foundations Law**" – The Budget Foundations Law, 1985.

"**Budget item**" – An item in the First Schedule or in the Second Schedule that determines the expenditures of a government ministry, a public authority or a public body or the expenditure on a matter of such extent or importance as warrants its determination in a separate item, divided into areas of operation where necessary.

"**Fiscal year 2013**" – The period commencing on January 1, 2013 and ending December 31, 2013.

"**Fiscal year 2014**" – The period commencing on January 1, 2014 and ending December 31, 2014.

"**Area of operation**" – A part of a budget item that is allocated to a particular matter, divided into plans where necessary.

"**Plan**" – A part of an area of operation that is allocated to a particular matter.

Any other term in this Law shall have the meaning assigned to it in the Budget Foundations Law.

Expenditure budget for fiscal year 2013 and its allocation

2. (a) The Government is permitted to expend in fiscal year 2013 a sum of NIS 395,032,948,000 (hereinafter – 2013 expenditure budget). This sum consists of a regular budget in the amount of NIS 279,845,639,000 and a development and capital account budget in the amount of NIS 115,187,309,000.

   (b) The division of the 2013 expenditure budget into budget items, areas of operation and plans shall be as detailed in the second column in Part I of the First Schedule, titled "Expenditure."

Expenditure budget for fiscal year 2014 and its allocation

3. (a) The Government is permitted to expend in fiscal year 2014 a sum of NIS 406,264,956,000 (hereinafter – 2014 expenditure budget). This sum consists of a regular budget in the amount of NIS 286,931,770,000 and a development and capital account budget in the amount of NIS 119,333,186,000.

   (b) The division of the 2014 expenditure budget into budget items, areas of operation and plans shall be as detailed in the second column in Part II of the Second Schedule, titled "Expenditure."

Revenue-dependent expenditure budget for fiscal year 2013

4. (a) In addition to the 2013 expenditure budget, the Government may expend in fiscal year 2013, as revenue-dependent expenditures within the meaning of Sections 5(a) and 5(b) of the Budget Foundations Law (hereinafter – 2013 revenue-dependent expenditure budget), a sum of NIS 21,860,357,000. This sum consists of a regular budget in the amount of NIS 17,194,449,000 and a development and capital account budget in the amount of NIS 4,665,908,000.

   (b) The division of the 2013 revenue-dependent expenditure budget into budget items, areas of operation and plans shall be as detailed in the third column in Part I of the First Schedule, titled "Revenue-Dependent Expenditure."

Revenue-dependent expenditure budget for fiscal year 2014

5. (a) In addition to the 2014 expenditure budget, the Government may expend in fiscal year 2014, as revenue-dependent expenditures within the meaning of Sections 5(a) and 5(b) of the Budget Foundations Law (hereinafter – 2014 revenue-dependent expenditure budget), a sum of NIS 22,440,677,000. This sum consists of a regular budget in the amount of NIS 18,017,328,000 and a development and capital account budget in the amount of NIS 4,423,349,000.

(b) The division of the 2014 revenue-dependent expenditure budget into budget items, areas of operation and plans shall be as detailed in the third column in Part II of the First Schedule, titled "Revenue-Dependent Expenditure."

Maximum workforce for fiscal year 2013

6. (a) In fiscal year 2013, the Government is permitted to fill positions up to a maximum workforce of 73,619 positions.

(b) The division of the maximum workforce specified in Subsection (a) into budget items, areas of operation and plans shall be as detailed in the fifth column in Part I of the First Schedule, titled "Maximum Workforce."

Maximum workforce for fiscal year 2014

7. (a) In fiscal year 2014, the Government is permitted to fill positions up to a maximum workforce of 74,273 positions.

(b) The division of the maximum workforce specified in Subsection (a) into budget items, areas of operation and plans shall be as detailed in the fifth column in Part II of the First Schedule, titled "Maximum Workforce."

Business enterprises – budget, maximum workforce and forecast of revenues for fiscal years 2013-2014

8. (a) In addition to the 2013 expenditure budget and the 2013 revenue-dependent expenditure budget, the Government is permitted to expend in 2013, as a business enterprise budget, a sum of NIS 16,065,917,000. The division of this sum into budget items, areas of operation and plans shall be as detailed in the second column in Part I of the Second Schedule, titled "Expenditure."

(b) In addition to the 2014 expenditure budget and the 2014 revenue-dependent expenditure budget, the Government is permitted to expend in 2014, as a business enterprise budget, a sum of NIS 16,379,251,000. The division of this sum into budget items, areas of operation and plans shall be as detailed in the second column in Part II of the Second Schedule, titled "Expenditure."

(c) In addition to the number of positions the Government may fill in fiscal year 2013 under Section 6(a), in fiscal year 2013 the Government is permitted to fill positions in business enterprises up to a maximum workforce of 21,448.5 positions. The division of said maximum workforce into budget items, areas of operation and plans shall be as detailed in the fifth column in Part I of the Second Schedule, titled "Maximum Workforce."

(d) In addition to the number of positions the Government may fill in fiscal year 2014 under Section 7(a), in fiscal year 2014 the Government is permitted to fill positions in business enterprises up to a maximum workforce of 21,447.5 positions. The division of said maximum workforce into budget items, areas of operation and plans shall be as detailed in the fifth column in Part II of the Second Schedule, titled "Maximum Workforce."

(e) The forecast revenue for coverage of the business enterprise budget in fiscal year 2013 is as detailed in Part I of the Second Schedule.

(f) The forecast revenue for coverage of the business enterprise budget in fiscal year 2014 is as detailed in Part II of the Second Schedule.

Provisions concerning use of general reserve for specific purposes

9. In fiscal years 2013-2014, regarding use of amounts from the "general reserve" budget item for a purpose within the activity of the Prime Minister's Office pursuant to Section 12 of the Budget Foundations Law, said section shall be read as if the following appeared at the end of Subsection (a) thereof: "For purposes of this section, 'Committee' – a special committee to be appointed by the Foreign Affairs and Defense Committee of the Knesset from among its members."

Use of adjustments budget for fiscal year 2014

10. Use of amounts from the adjustments budget for 2014 shall be in accordance with the provisions of Section 1(a)(5a) of the Basic Law: State Budget for 2009-2014 (Special Provisions) (Temporary Order) and Section 179A of the Economic Efficiency Law (Legislative Amendments to Implement the Economic Plan for 2009-2010), 2009.

Forecast of State revenues and loans

11. The forecast of State revenues and loans for fiscal years 2013-2014, as provided in Section 2(b)(1) of the Budget Foundations Law, is as detailed in the Third Schedule.

Forecast of uncollected tax due to tax benefits

12. The forecast of uncollected tax due to tax benefits, for fiscal years 2013-2014, as provided in Section 2(b)(2) of the Budget Foundations Law, is as detailed in the Fourth Schedule.

Application of the Budget Foundations Law

13. The provisions of this Law shall not derogate from the provisions of the Budget Foundations Law, and any change in the amounts specified in this Law and in their distribution shall be in accordance with the provisions of said law.

Inception

14. This Law is effective as of January 1, 2013.

Publication

15. This Law shall be published in Reshumot (the Official Gazette of the Israeli Government) within three months of its ratification.

Budget Bill for Fiscal Year 2013

(In NIS Thousands)

Summary of the First Schedule		Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
Grand Total		**395,032,948**	**21,860,357**	**117,957,382**	**73,619**
=========		=========	========	=========	=====
Budget for calculation of expenditure limit *		309,543,948			
Debt repayments excluding debt repayments to National Insurance		85,489,000			
Part I:	Regular budget	279,845,639	17,194,449	69,902,153	73,619
Part II:	Development and capital account budget	115,187,309	4,665,908	48,055,229	
Part I:	**Regular Budget**	**279,845,639**	**17,194,449**	**69,902,153**	**73,619**
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	Government and administration	**43,383,231**	**3,297,729**	**2,929,795**	**49,619.5**
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01	President of the State	43,624	800		60
02	The Knesset**	594,238	180		646
03	Cabinet members				
04	Prime Minister's Office	2,545,791	50,871	115,912	948.5
05	Ministry of Finance	1,959,450	284,796		5,492
06	Ministry of the Interior	673,715	11,100	148,500	596.5
07	Ministry of Public Security	12,348,879	986,547	2,477,383	32,555
08	Ministry of Justice	2,861,344	726,569		5,895.5
09	Ministry of Foreign Affairs	1,592,113	50,497		1,058
10	National Security Council	40,876			2
11	State Comptroller***	291,207		40,500	580
12	Pension benefits and severance pay	13,410,536	668,229		
13	Miscellaneous expenses	4,686,471			
14	Financing of political parties	384,506			
19	Ministry of Science, Technology & Space and Ministry of Culture & Sport	1,117,322	42,381	127,500	112.5
26	Ministry of Environmental Protection	310,550	391,337		510
68	Population, Immigration & Border Authority	522,608	84,422	20,000	1,163.5
	Defense	**52,844,172**	**6,031,293**	**32,000,000**	**2,453**
	======	========	=======	========	======
15	Ministry of Defense	52,352,073	5,900,294	32,000,000	2,163
16	Civil emergency expenses	391,445			42
17	Coordination of activities in the territories	100,654	130,999		248

Budget Bill for Fiscal Year 2013 (cont.)

Summary of the First Schedule		**Expenditure**	**Revenue-Dependent Expenditure**	**Spending Authorization**	**Maximum Workforce**
18	**Local authorities**	**3,487,615**		**355,226**	
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	Social services	**124,279,593**	**6,935,334**	**21,857,581**	**16,114**
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20	Ministry of Education	42,425,121	1,678,477	157,000	2,248
21	Higher education	8,830,539			
23	Ministry of Social Affairs	5,337,970	1,742,599	81,183	3,004.5
24	Ministry of Health	22,705,849	3,339,896	224,555	9,750
27	Transfers to National Insurance	31,582,155			
25	Holocaust Survivors Rights Authority	3,141,804			70.5
29	Ministry of Construction & Housing	194,487	5,000		608.5
30	Ministry of Immigrant Absorption	1,397,115	1,900	650,000	411.5
32	Miscellaneous support	6,599,471	167,462	20,744,843	
46	Discharged Soldiers Law	2,065,081			21
56	Commission for Equal Rights for Persons with Disabilities				
	Economy and administration	**9,315,616**	**930,093**	**2,759,551**	**4,932.5**
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33	Ministry of Agriculture & Rural Development	518,745	200,745	49,751	1,331
34	Ministry of Energy & Water	216,004	49,000	30,000	299
35	Israel Atomic Energy Commission	147,927			
36	Ministry of Economy	3,061,901	42,101	339,000	1,902
37	Ministry of Tourism	229,546	8,286	15,000	146.5
38	Support for economic sectors	2,060,827	479,898	2,302,000	
39	Ministry of Communications	52,336	20,150		89
40	Ministry of Transport, National Infrastructure & Road Safety	452,995	102,838	23,000	743.5
41	Government Water & Sewage Authority	102,267	1,655		125.5
42	Construction and housing grants	2,077,084	4,320		
43	Israel Mapping Center	91,177	20,800	800	235
54	Regulatory authorities	304,806	300		61
45	**Interest and commission payments**	**39,459,000**			
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	Reserves	**7,076,413**		**10,000,000**	**500**
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47	General reserve	7,076,413		10,000,000	500

Budget Bill for Fiscal Year 2013 (cont.)

Summary of the First Schedule		Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Personnel
Part II:	**Development and Capital Account Budget**	**115,187,309**	**4,665,908**	**48,055,229**	
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	Development budget	19,819,309	4,665,908	48,055,229	
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	Investments in government and administration	**711,521**	**555,933**	**2,961,055**	
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51	Government housing	106,821	500,533	2,213,670	
52	Police and prisons	518,128	55,400	717,070	
53	Courts	86,572		30,315	
55	Treasury				
	Investments in social services	**2,747,581**	**2,409,123**	**5,129,104**	
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60	Education	1,010,370		1,818,015	
67	Health	413,335	84,423	300,000	
70	Housing	1,323,876	2,324,700	3,011,089	
	Investments in economic sectors	**16,360,207**	**1,700,852**	**39,965,070**	
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73	Water works	1,072,756	2,450	900,000	
76	Industrial development	40,740	50,000	170,000	
78	Tourism	479,917	50,000	1,251,500	
79	Transport	11,828,289	43,714	36,346,934	
83	Miscellaneous development expenses	2,938,504	1,554,688	1,296,636	
84	Debt repayments	95,368,000			
	Of which: Debt repayments to National Insurance	9,879,000			
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* Net budget (NIS 395,032,948) less debt repayments (NIS 95,368,000) excluding debt repayments to National Insurance (NIS 9,879,000). This sum includes a one-time amount for fiscal year 2013 (NIS 6,663,373) which is not included in the expenditure limit under Section 6A(b) of the Deficit Reduction and Budget Expenditure Limitation Law.

** The Knesset's annual budget proposal is submitted for approval to the House Committee of the Knesset by the Chairman of the Knesset, and is part of the Budget Law.

*** The State Comptroller budget is set by the Finance Committee of the Knesset, and is part of the Budget Law. Details of this budget are published separately, pursuant to the Basic Law: State Comptroller.

Budget Bill for Fiscal Year 2014

(In NIS Thousands)

	Summary of the First Schedule	Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
Grand Total		**406,264,956**	**22,440,677**	**92,120,091**	**74,273**
Budget for calculation of expenditure limit *		320,261,956			
Debt repayments excluding debt repayments to National Insurance		86,003,000			
Part I:	Regular budget	286,931,770	18,017,328	50,579,945	74,273
Part II:	Development and capital account budget	119,333,186	4,423,349	41,540,146	
Part I:	**Regular Budget**	**286,931,770**	**18,017,328**	**50,579,945**	**74,273**
	Government and administration	**45,454,013**	**3,264,612**	**2,971,556**	**50,217.5**
01	President of the State	40,340	800		60
02	The Knesset**	595,291	180		646
03	Cabinet members				
04	Prime Minister's Office	2,290,365	26,281	78,441	930.5
05	Ministry of Finance	2,005,638	285,004		5,494
06	Ministry of the Interior	374,031	11,100	145,515	591.5
07	Ministry of Public Security	13,202,507	954,615	2,593,610	33,135
08	Ministry of Justice	2,909,322	739,581		5,962.5
09	Ministry of Foreign Affairs	1,638,724	50,497		1,048
10	National Security Council	40,124			2
11	State Comptroller***	291,208			580
12	Pension benefits and severance pay	15,005,776	678,396		
13	Miscellaneous expenses	4,949,075			
14	Financing of political parties	142,731			
19	Ministry of Science, Technology & Space and Ministry of Culture & Sport	1,130,704	42,381	133,990	110.5
26	Ministry of Environmental Protection	323,450	391,355		505
68	Population, Immigration & Border Authority	514,728	84,422	20,000	1,152.5
	Defense	**51,268,997**	**6,826,687**	**32,000,000**	**2,421**
15	Ministry of Defense	50,852,073	6,695,516	32,000,000	2,131
16	Civil emergency expenses	316,081			42
17	Coordination of activities in the territories	100,843	131,171		248

Budget Bill for Fiscal Year 2014 (cont.)

Summary of the First Schedule		Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Personnel
18	**Local authorities**	**3,489,617**		**349,226**	
	Social services	**127,546,897**	**6,991,941**	**2,910,465**	**16,227**
20	Ministry of Education	44,126,921	1,681,286	193,000	2,241
21	Higher education	9,129,187			
23	Ministry of Social Affairs	5,623,688	1,754,170	81,183	3,154.5
24	Ministry of Health	23,690,528	3,382,123	224,555	9,730
27	Transfers to National Insurance	30,749,597			
25	Holocaust Survivors Rights Authority	3,388,710			69.5
29	Ministry of Construction & Housing	186,206	5,000		599.5
30	Ministry of Immigrant Absorption	1,415,058	1,900	650,000	411.5
32	Miscellaneous support	7,022,245	167,462	1,761,727	
46	Discharged Soldiers Law	2,214,758			21
56	Commission for Equal Rights for Persons with Disabilities				
	Economy and administration	**10,025,864**	**934,088**	**2,348,698**	**4,907.5**
33	Ministry of Agriculture & Rural Development	521,697	200,745	57,100	1,312
34	Ministry of Energy & Water	213,034	49,000	30,000	298
35	Israel Atomic Energy Commission	147,927			
36	Ministry of Economy	3,683,360	46,096	431,000	1,890
37	Ministry of Tourism	226,026	8,286	15,000	144.5
38	Support for economic sectors	2,175,438	479,898	1,791,798	
39	Ministry of Communications	55,817	20,150		88
40	Ministry of Transport, National Infrastructure & Road Safety	446,859	102,838	23,000	733.5
41	Government Water & Sewage Authority	100,075	1,655		123.5
42	Construction and housing grants	2,050,228	4,320		
43	Israel Mapping Center	90,124	20,800	800	231
54	Regulatory authorities	315,277	300		87
45	**Interest and commission payments**	**41,745,000**			
	Reserves	**7,401,381**		**10,000,000**	**500**
47	General reserve	7,401,381		10,000,000	500

Budget Bill for Fiscal Year 2014 (cont.)

Summary of the First Schedule		Expenditure	Revenue-Dependent Expenditure	Spending Authorization	Maximum Personnel
Part II:	**Development and Capital Account Budget**	**119,333,186**	**4,423,349**	**41,540,146**	
	Development budget	22,471,186	4,423,349	41,540,146	
	Investments in government and administration	**846,820**	**245,588**	**2,721,785**	
51	Government housing	143,821	190,188	1,880,820	
52	Police and prisons	596,236	55,400	810,650	
53	Courts	106,763		30,315	
55	Treasury				
	Investments in social services	**3,535,749**	**2,402,123**	**5,241,676**	
60	Education	1,881,283		1,811,615	
67	Health	323,336	77,423	450,000	
70	Housing	1,331,130	2,324,700	2,980,061	
	Investments in economic sectors	**18,088,617**	**1,775,638**	**33,576,685**	
73	Water works	1,266,635	2,450	1,250,000	
76	Industrial development	39,210	50,000	170,000	
78	Tourism	490,693	50,000	483,000	
79	Transport	12,915,274	98,500	30,594,114	
83	Miscellaneous development expenses	3,376,805	1,574,688	1,079,571	
84	Debt repayments	96,862,000			
	Of which: Debt repayments to National Insurance	10,859,000			

* Net budget (NIS 406,264,956) less debt repayments (NIS 96,862,000) excluding debt repayments to National Insurance (NIS 10,859,000).

** The Knesset's annual budget proposal is submitted for approval to the House Committee of the Knesset by the Chairman of the Knesset, and is part of the Budget Law.

*** The State Comptroller budget is set by the Finance Committee of the Knesset, and is part of the Budget Law. Details of this budget are published separately, pursuant to the Basic Law: State Comptroller.

Budget Proposal for Business Enterprises, Fiscal Year 2013

(In NIS Thousands)

Summary of the Second Schedule		Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
	Total revenues	**16,065,917**		
	=============	=========		
89	Prime Minister's Office and Ministry of Finance*	401,030		
94	Government hospitals	8,648,063		
95	Jaffa and Hadera Ports	42,123		
98	Israel Land Administration (ILA)	6,974,701		
	Total expenditures	**16,065,917**	**1,766,500**	**21,448.5**
	================	=========	========	=======
89	Prime Minister's Office and Ministry of Finance*	401,030		95
94	Government hospitals	8,648,063		20,779.5
95	Jaffa and Hadera Ports	42,123	66,500	5
98	Israel Land Administration (ILA)	6,974,701	1,700,000	569

* Government Press Office and Government Printer

Budget Proposal for Business Enterprises, Fiscal Year 2014

(In NIS Thousands)

Summary of the Second Schedule		Revenue-Dependent Expenditure	Spending Authorization	Maximum Workforce
	Total revenues	**16,379,251**		
89	Prime Minister's Office and Ministry of Finance*	400,923		
94	Government hospitals	9,011,634		
95	Jaffa and Hadera Ports	41,994		
98	Israel Land Administration (ILA)	6,924,700		
	Total expenditures	**16,379,251**	**1,700,000**	**21,447.5**
89	Prime Minister's Office and Ministry of Finance*	400,923		94
94	Government hospitals	9,011,634		20,779.5
95	Jaffa and Hadera Ports	41,994		5
98	Israel Land Administration (ILA)	6,924,700	1,700,000	569

* Government Press Office and Government Printer

Forecast of State Revenues and Loans for Fiscal Years 2013-2014

(In NIS Thousands)

		2013 Budget Proposal	2014 Budget Proposal
	Total revenues and grants, net*	263,350,507	288,492,664
	Grand total	**395,032,948**	**406,264,956**
	==========	==========	==========
	Part I: Current receipts	279,845,639	286,931,770
	Part II: Receipts from loans and capital account	115,187,311	119,333,188
	Part I: Current Receipts	**279,845,639**	**286,931,770**
	====================	==========	==========
	Taxes and compulsory payments	235,952,676	259,166,155
	Income and property taxes	112,800,000	126,300,000
001	Income tax	94,100,000	105,900,000
002	VAT on nonprofit organizations and financial institutions	11,800,000	12,400,000
003	Betterment tax	2,200,000	2,400,000
004	Purchase tax	4,300,000	5,200,000
005	Sales tax and property tax		
007	Employers tax	400,000	400,000
-			
	Expenditure taxes	123,152,676	132,866,155
011	Customs and import duties	2,400,000	2,600,000
012	VAT, including VAT on defense imports	81,652,676	89,066,155
013	Purchase tax	16,300,000	17,600,000
015	Excise tax	1,000,000	1,100,000
016	Fuel tax	16,100,000	16,500,000
020	Stamp duty		
024	Motor vehicle fees		
025	License fees and other levies	5,700,000	6,000,000
	Interest and earnings	1,358,749	1,358,190
034	Interest in foreign currency	285,773	264,724
035	Interest in NIS	1,072,976	1,093,466

Forecast of State Revenues and Loans for Fiscal Years 2013-2014 (cont.)

		2013 Budget Proposal	2014 Budget Proposal
	Royalties	1,334,471	1,423,844
042	Royalties from business enterprises	32,602	33,580
043	Royalties from natural resources	861,697	887,548
044	Royalties from government-owned companies	114,797	118,241
045	Dividends from government-owned companies	325,375	384,475
	Miscellaneous revenues	1,231,672	1,501,621
046	Reimbursement on account of previous years' budgets	59,742	61,534
047	Revenues from various services	713,215	837,611
050	Government asset utilization fees	238,407	245,559
048	Earmarked revenues in excess of estimate	220,308	356,917
049	Profits realized by Bank of Israel		
	Carried from Part II	39,968,071	23,481,960
	Part II: Receipts from Loans and Capital Account	**115,187,311**	**119,333,188**
	Repayment of government investments and loans	5,159,718	4,982,806
051	Collection of principal in NIS	4,674,016	4,485,618
053	Collection of principal in foreign currency	335,7702	347,188
076	Revenues from sale of state-owned lands	150,000	150,000
	Provisions for pension benefits and severance pay	13,144	13,538
071	Provisions by economic units	9,963	10,262
072	Provisions by business enterprises		
073	Provisions for pension – companies	3,181	3,276
	Capital revenues	1,132,000	1,132,000
075	Privatization	1,132,000	1,132,000

Forecast of State Revenues and Loans for Fiscal Years 2013-2014 (cont.)

		2013 Budget Proposal	2014 Budget Proposal
	Domestic loans	128,304,725	118,254,488
081	Loan from National Insurance Institute	14,564,000	16,247,000
082	Revenue from emissions and deposits	113,740,725	102,007,488
	Loans and grants from abroad	20,545,795	18,432,316
900	Independence and development loan	4,000,000	4,000,000
901	Net of: Distribution expenses	-200,000	-200,000
	Loans and grants from the USA		
902	- Defense	8,745,795	8,632,316
904	- Civilian assistance		
907	- Other loans	8,000,000	6,000,000
908	Bank loans		
	Carried to Part I	-39,968,071	-23,481,960

***** Total current receipts less amount carried from Part II plus revenues from sale of state-owned lands, provisions for pension benefits and severance pay, loan from National Insurance Institute and defense grant from the USA.

Forecast of Tax Benefits for Fiscal Years 2013-2014*

(In NIS Thousands)

	2013	2014
Total	**44,250**	**44,580**
Part I: Direct Taxes	**36,010**	**35,820**
A. Benefits for capital investments and industry	**6,470**	**6,900**
1. Encouragement of Capital Investments Law	6,300	6,700
2. Angels Law	..	..
3. R&D, gas exploration and film production	..	..
4. Credit for shift labor	170	..
5. Encouragement of Industry Law	..	..
6. Accelerated depreciation	..	..
7. Participation exemption	..	..
B. Benefits to the savings and capital market	**17,240**	**16,620**
1. Pension funds, net:	12,900	12,000
- Benefits upon deposit	10,000	9,300
- Benefits upon accrual	6,100	6,400
- Less taxation upon withdrawal	-3,200	-3,700
2. Advanced study funds**	4,120	4,390
- Benefits upon accrual	3,290	3,520
- Benefits upon deposit	830	870
3. Interest income	220	230
4. Tax on employee stock options in the capital gains track	..	..
C. Welfare and population distribution	**4,360**	**4,310**
1. Income tax exemption for nonprofit organizations	..	..
2. Exemption on Ministry of Defense allowances	450	500
3. Exemption on National Insurance allowances	1,860	1,600
- Child allowances	1,100	700
- Old-age and survivors benefits	690	830
- Other benefits	70	70
4. Credit for new immigrants	40	40
5. Credit for institutionalization of a relative	40	40
6. Credit for parents of disabled children	50	50
7. Credit for charitable donations	250	270

Forecast of Tax Benefits for Fiscal Years 2013-2014 (cont.)

		2013	2014
8.	Credit for the blind and disabled	250	280
9.	Credit for residents of development areas	1,340	1,440
10.	Credit for employers in Eilat	80	90
D.	**Household benefits (excluding exemption on child allowances)**	**3,690**	**4,140**
1.	Credit for single-parent families	110	120
2.	Half credit point for women	790	910
3.	Credit for children (including in single-parent families)	2,740	3,060
4.	Credit for nonworking spouse	30	30
5.	Credit for payers of child support and alimony	20	20
E.	**Miscellaneous income tax benefits**	**1,740**	**1,540**
1.	Exemption on income from gambling, lotteries and prizes	300	250
2.	Exemption on rentals of residential apartments	1,100	1,150
3.	Encouragement of construction of homes for rent	50	60
4.	Credit for discharged soldiers	70	70
5.	Credit for academics	210	..
6.	Credit for foreign athletes	10	10
F.	**Benefit-recipient funds and institutions**	..	..
1,	Edmond de Rothschild Caesarea Foundation	..	..
2.	Israel Academy of Sciences and Humanities	..	..
3.	Wolf Foundation	..	..
4.	United States-Israel Binational Science Foundation	..	..
G.	**Fringe benefits**	**310**	**320**
1.	Company car	310	320
2.	Parking at workplace	..	..
E.	**Real-estate tax benefits**	**2,200**	**2,190**
Part II: Indirect Taxes		**8,030**	**8,540**
A.	**Customs and purchase tax**	3,770	3,930
1.	Diesel fuel	2,850	2,950
2.	New immigrants	50	50
3.	Returning residents	10	10
4.	Domestic tourists	410	450

Forecast of Tax Benefits for Fiscal Years 2013-2014 (cont.)

	2013	2014
5. Vehicle safety accessories	260	270
6. Limited tax rate for taxis	160	170
7. Conditional exemptions	30	30
B. Value-added tax	**4,260**	**4,610**
1. Fruits and vegetables	2,560	2,760
2. Tourism services	980	1,070
3. Eilat Law	720	780
Part III: Fees	**210**	**220**

Source: State Revenue Administration

Benefits marked by "**..**" – There is no cost estimate due to a lack of databases.

* Full details on the tax benefits appear in the chapter "Forecast of Tax Benefits" below.

** In 2014, an additional NIS 1.4 billion should be attributed to this tax benefit, putting it at an estimated NIS 5.8 billion (see additional details under "Benefits to the capital market"). The estimate of benefits as presented does not take into account changes in behavioral patterns and other changes that reduce the potential for collection upon cancellation of the benefits.

Part II

General Overview

Key Economic Developments

Background

Following several years of rapid growth, the Israeli economy entered into a recession towards the end of 2008 as a result of the global economic crisis. However, the Israeli economy, unlike the majority of developed economies, recovered quickly from the crisis, achieving in the course of 2010-2011 relatively high growth rates. In spite of slightly decelerated growth starting from the second half of 2011, Israel maintained a reasonable growth rate in 2012 that surpassed other developed countries.

The slowdown in economic growth was reflected in weaker exports of goods and services and reduced fixed-asset investments starting from the second half of 2011. This downtrend is attributable to a decline in global demand and to geopolitical developments in the Middle East, which among other things led to the suspension of the supply of natural gas from Egypt. The uncertain global economic environment and the geopolitical situation contributed to a fall in share prices in Israel and the world.

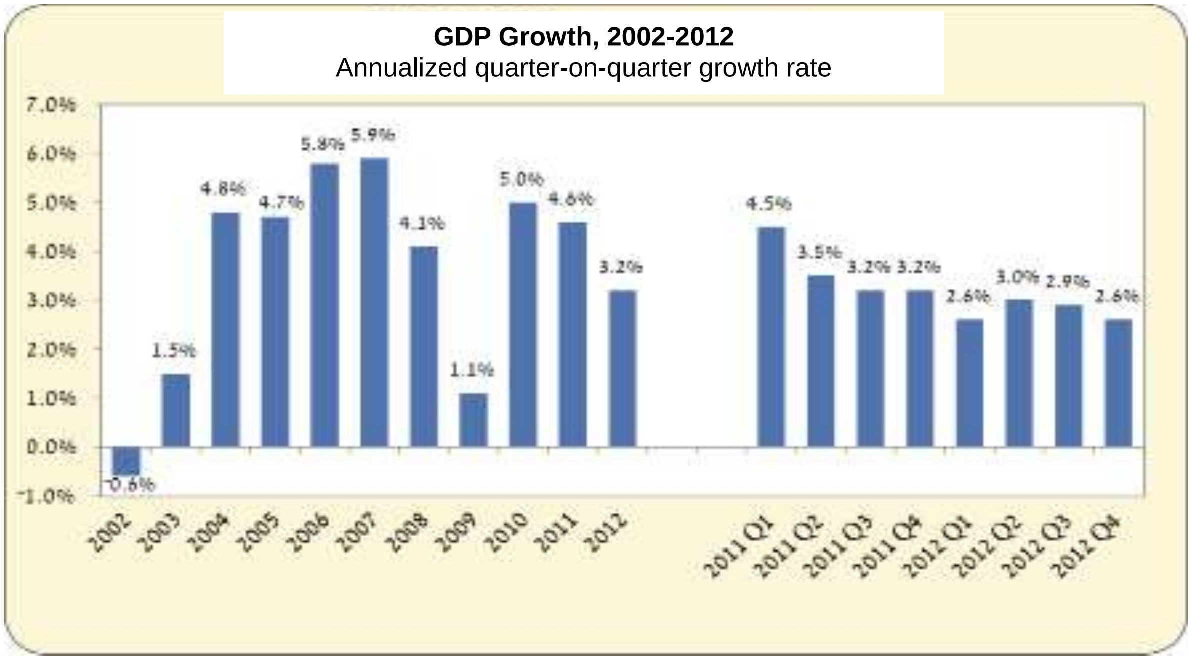
The slowdown in the Israeli economy did not halt the continuing improvement in the country's labor market over the past two years, reflected in higher participation rates as well as lower unemployment rates. However, the wage for an employee job rose only moderately.

The second quarter of 2013 saw the start of production from the natural gas reserves discovered in Israel's economic waters. We estimate that in 2013 natural gas production will contribute 0.9 percentage points to growth and improve the current account of the balance of payments.

The Real Economy

Following slow growth of 1.1% in 2009, the Israeli economy registered significantly improved growth rates in 2010-2011, with the GDP growing in these years at a rate of 5% and 4.6% respectively.

Nevertheless, economic growth in Israel slowed starting from the second half of 2011, reaching a rate of 3.2% in 2012, in spite of which the growth rate of the Israeli economy remained among the highest in the OECD.



Source: Central Bureau of Statistics.

This slowdown is attributable among other factors to the global economic uncertainty (resulting from the Eurozone crisis, the U.S. fiscal crisis and the slowdown in the emerging economies) as well as the geopolitical situation in the Middle East. In our estimation, the suspension of the natural gas supply from Egypt reduced the GDP by approximately 0.2% in 2011 and 0.8% in 2012.

During 2012 the growth rate of the Israeli economy stabilized around 3.0%. The rapid growth in 2010-2011 led to a positive output gap, however the slowing of growth beginning in the second half of 2011 eroded the output gap, and in 2012 this gap was negligible.

The high growth rates recorded from mid-2009 until mid-2011 were driven primarily by two growth engines: investments in fixed assets and exports of goods and services. Three main factors contributed to the sharp increase in fixed-asset investments: accelerated investment in residential construction due to the spiraling of housing prices, coupled with government incentives; investments in infrastructure for extracting natural gas from the Mediterranean Sea, and Intel's investment in upgrading its production facilities in Kiryat Gat. (The upgrading of the Kiryat Gat production facilities contributed to a growth in investments, but temporarily affected Israeli exports of goods, reflected in a sharp drop in exports of electronic components in 2011. Following the completion of the upgrade, exports of electronic components registered a substantial increase.)

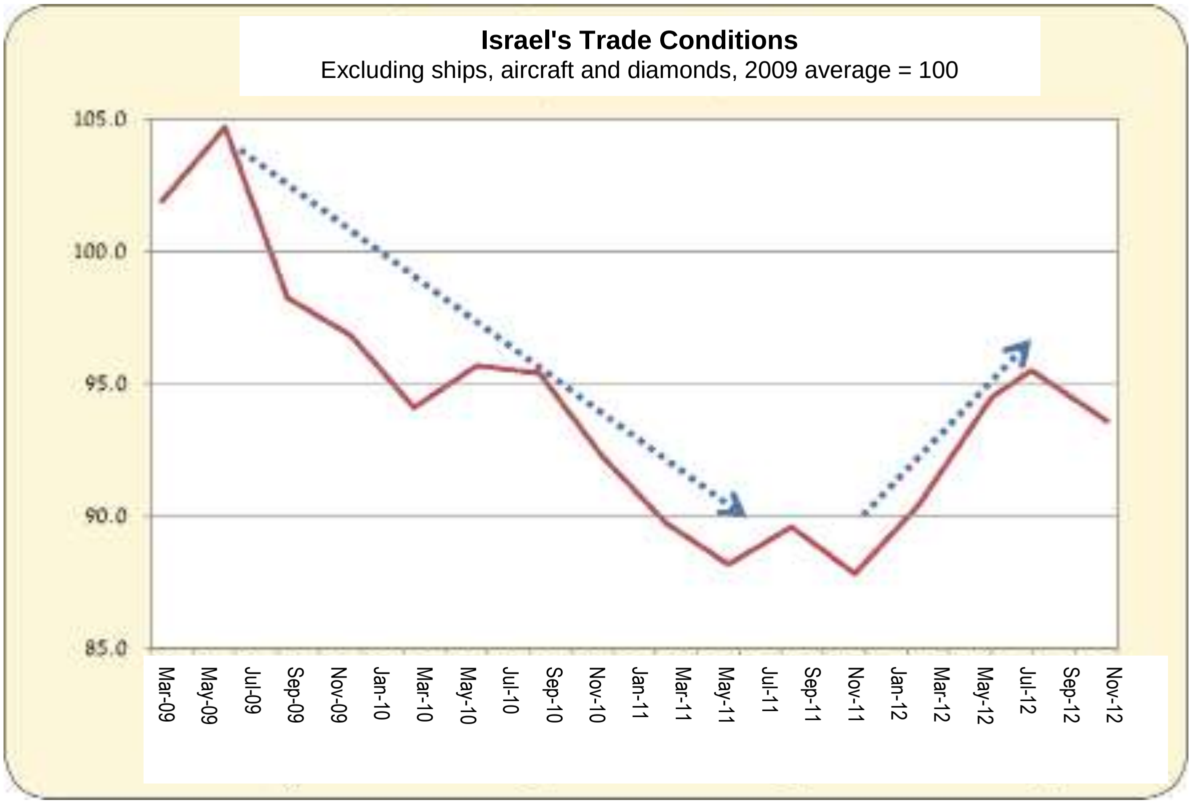
Following the large one-time investments in natural gas infrastructure and in the Intel production facilities, which significantly boosted the amount of capital in the Israeli economy, investments in the economy declined significantly beginning in the second half of 2011, recording even negative growth in recent quarters.

Private consumption slowed in 2011-2012. Thus, following an increase of 5.3% in 2010, the growth rate of private consumption fell to 3.8% in 2011 and to 2.7% in 2012. The downtrend in 2011 is explained by a decrease in current consumption, while in 2012 it is explained by lower consumption of durable goods.

Public consumption grew in 2012 at an accelerated rate of 3.7%, following an increase of 2.9% in each of the years 2010-2011. The growth rate in 2012 was the fastest in the last ten years, reflecting a sharp rise in civilian public expenditure.

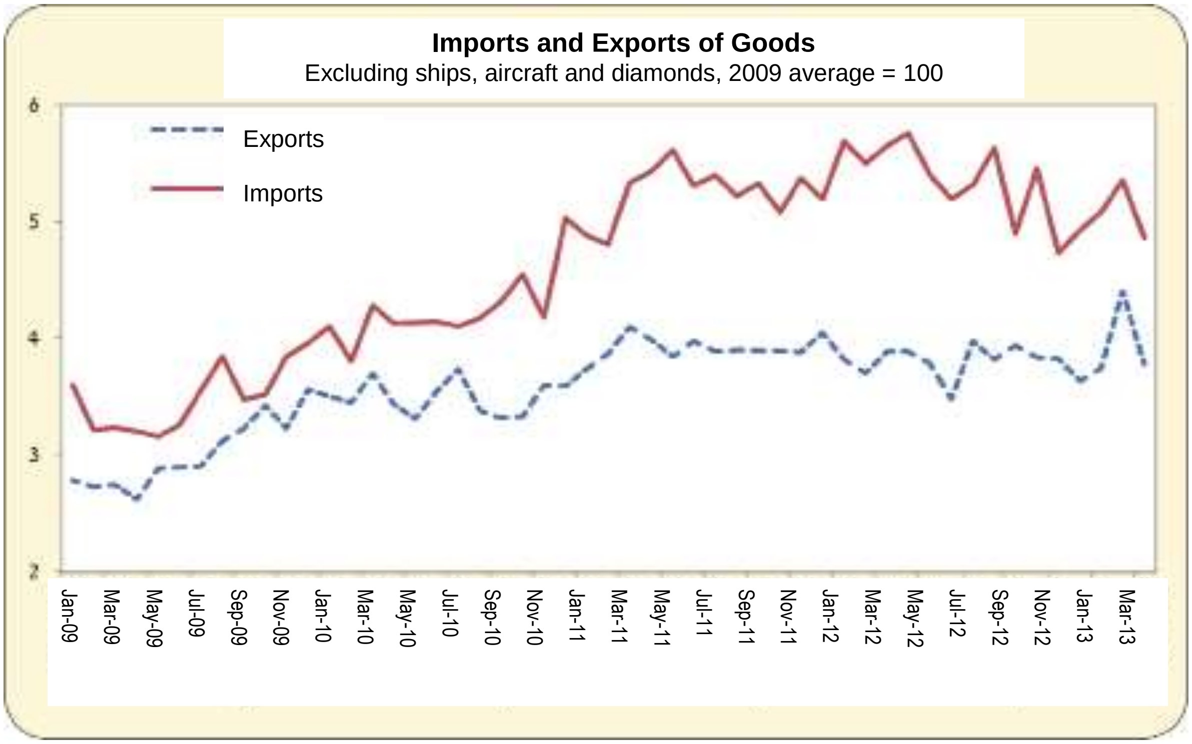
Foreign Trade and the Balance of Payments

The growth of exports decelerated significantly from the beginning of 2011, due among other reasons to the slowing of international trade, the worsening of Israel's trade conditions, the shekel's appreciation and the upgrading of Intel's production facilities in Kiryat Gat. The improvement in trade conditions in the last quarters, as well as the completion of the upgrading of Intel's Kiryat Gat production facilities, contributed to renewed – albeit temporary – acceleration in the second quarter of 2012. In spite of this acceleration, the growth rate of exports stood at only 0.1% in 2012 (discounting diamonds, exports grew by 4.3%), following an increase of 13.5% and 5.5% in 2010 and 2011 respectively. The decline in growth of exports in 2012 was mainly due to lower exports of goods to Europe and the U.S., with an especially sharp decline recorded in the non-high-tech sectors, which are highly dependent on exports to Europe, and in pharmaceutical exports to the U.S., contrasted with exports of goods to Asia, which continued to grow. Another encouraging development was recorded in exports of services (excluding tourism), which increased in 2012 at a relatively rapid rate of 7.2%. Exports of high-tech services (accounting for 40% of total exports of services) grew at an especially rapid rate, continuing the sharp uptrend in 2011 resulting from strong global demand in this area.



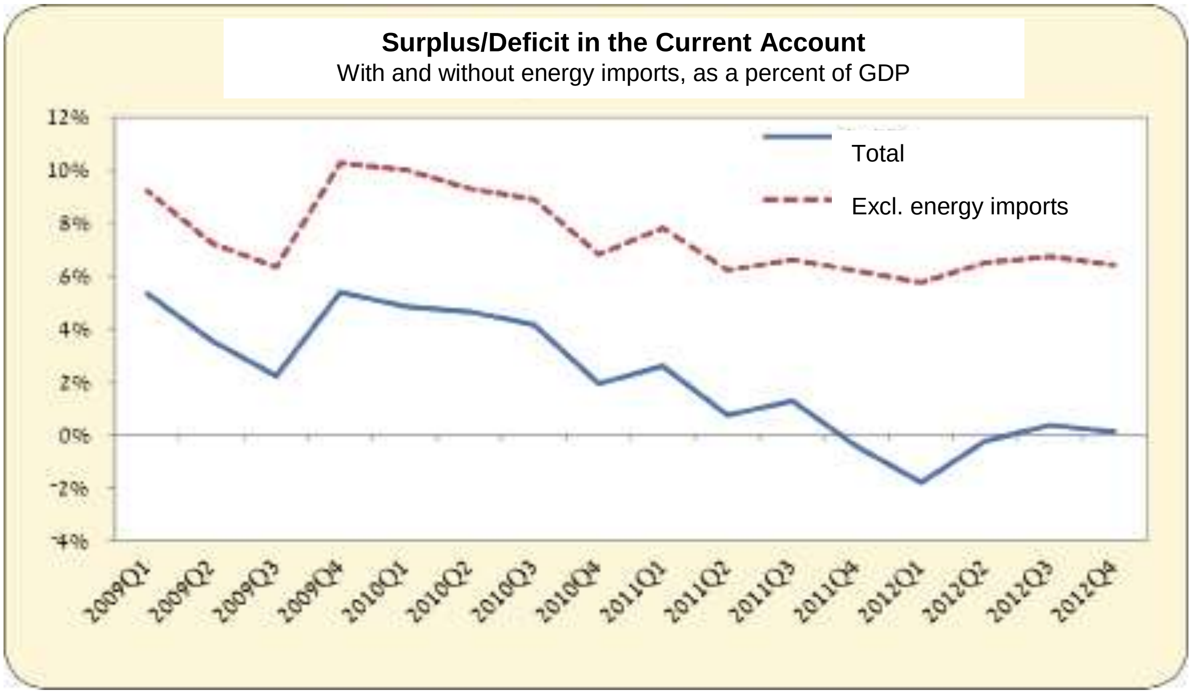
An increase in trade conditions represents improved competitiveness of Israeli exports.
Source: Central Bureau of Statistics

Developments in the import sector in 2011-2012 included increased imports of equipment for the construction of natural gas infrastructure and for the Intel production facilities upgrade, as well as a sharp rise in imports of energy resources following the cutoff in the supply of Egyptian natural gas. Israeli imports of goods and services grew in 2012 by 3.4%, considerably below the growth rates recorded in 2010-2011 (12.5% and 11.1% respectively). Imports of goods fluctuated widely from the middle of 2012, due to fluctuations in imports of energy resources, which are expected to continue at least until the start of production of natural gas from the Tamar reserve.



Source: Central Bureau of Statistics

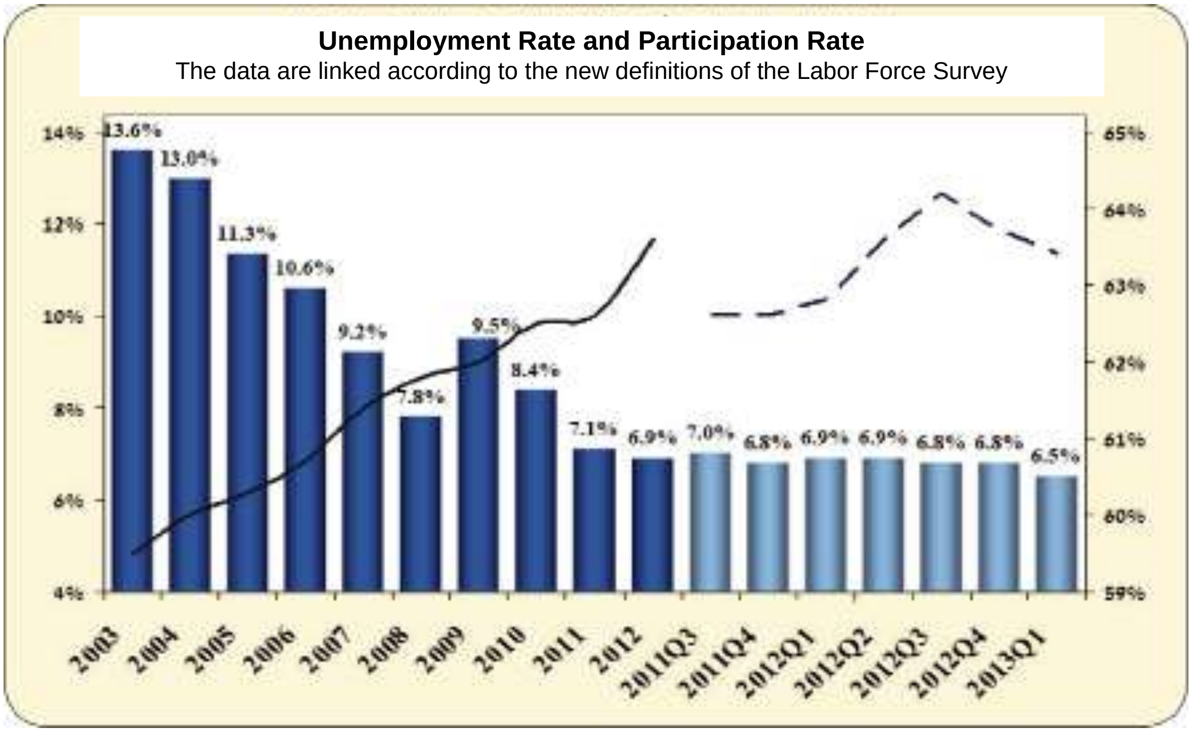
Following close to a decade of a surplus in the current account of the balance of payments, starting from the second quarter of 2011 the surplus decreased, and between the fourth quarter of 2011 and the second quarter of 2012 the current account even registered a deficit. The deficit in those quarters was a direct result of the increased cost of energy imports following the cutoff of the Egyptian natural gas supply to Israel, which forced the Israeli economy to switch to more costly energy resources. Israeli production of natural gas from the Tamar reserve, starting from the second quarter of 2013, is expected to contribute to an improvement in the current account of the balance of payments.



Source: Central Bureau of Statistics

The Labor Market and Inequality

The Israeli labor market has shown a sustained improvement since the second quarter of 2009, with the unemployment rate declining from 10% in the second quarter of 2009 to 6.8% in the fourth quarter of 2012, together with a significant improvement in the participation rate. Thus, the participation rate rose from 62.6% in 2010-11 to 63.6% in 2012, while the unemployment rate declined from 8.4% in 2010 to 7.1% in 2011 and 6.9% in 2012. In this period (between the second quarter of 2009 and the fourth quarter of 2012) approximately 360,000 employed persons were added to the Israeli workforce. The improvement in the Israeli labor market is especially notable in an international comparison, according to which many developed countries suffer from extremely high unemployment rates.

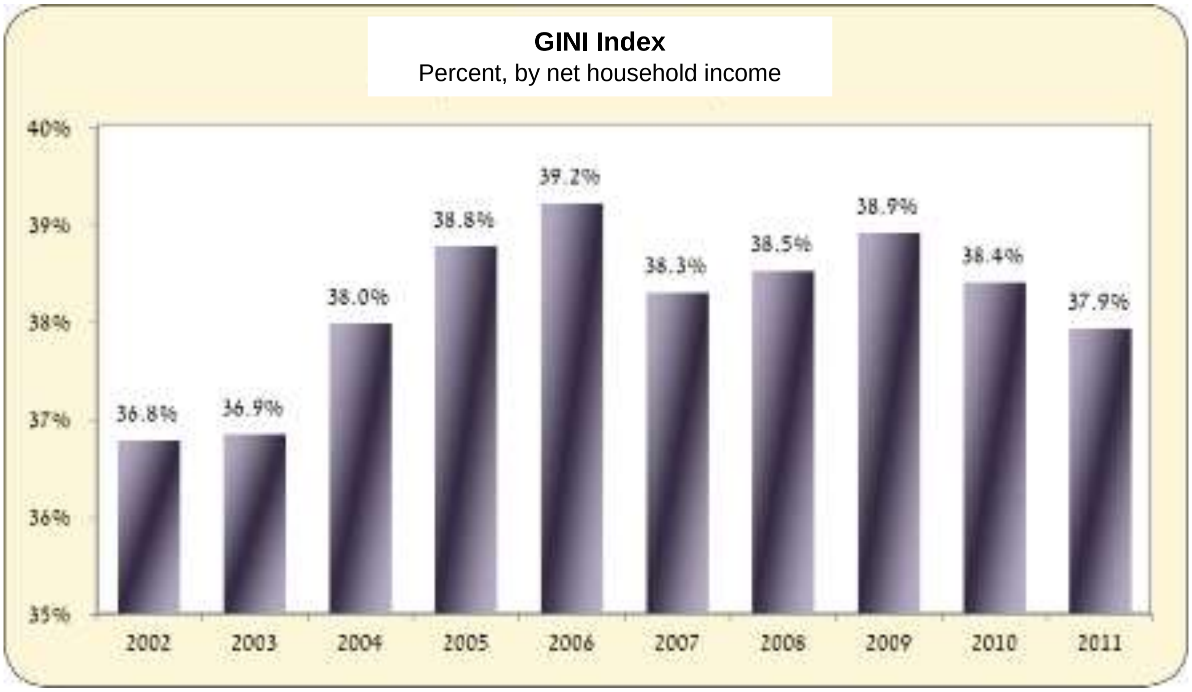


Unemployment Rate and Participation Rate
The data are linked according to the new definitions of the Labor Force Survey

Source: Central Bureau of Statistics

Despite the improvement in the labor market, the real wage per employee job has risen at a slow rate in recent years. In the business sector, the current wage levels are lower than those that prevailed before the latest crisis, while in the public services sector they are similar to the pre-crisis levels.

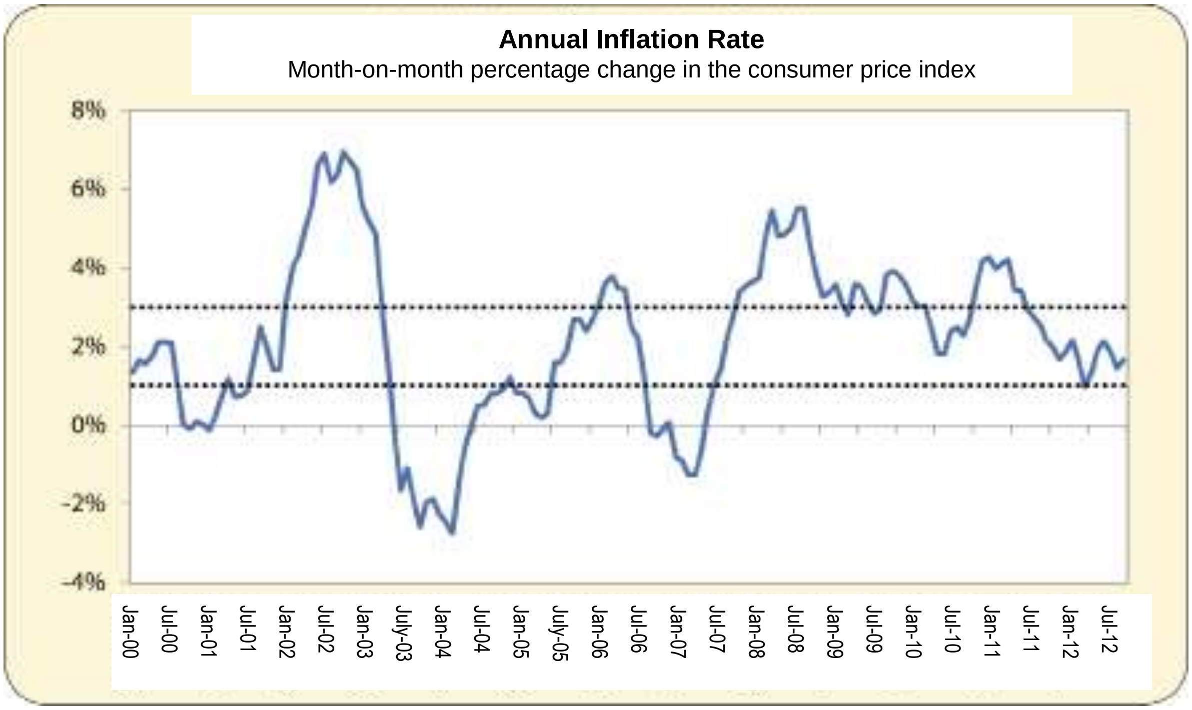
The rapid expansion of the Israeli labor market between 2009 and 2011 resulted in a slight decline in inequality in the Israeli economy as measured by the GINI index, which decreased by 1.0 percentage point between 2009 and 2011. Nonetheless, inequality in the Israeli economy remains relatively high compared to most OECD countries, and it has grown since the beginning of the previous decade.



Source: Poverty Report of the National Insurance Institute.

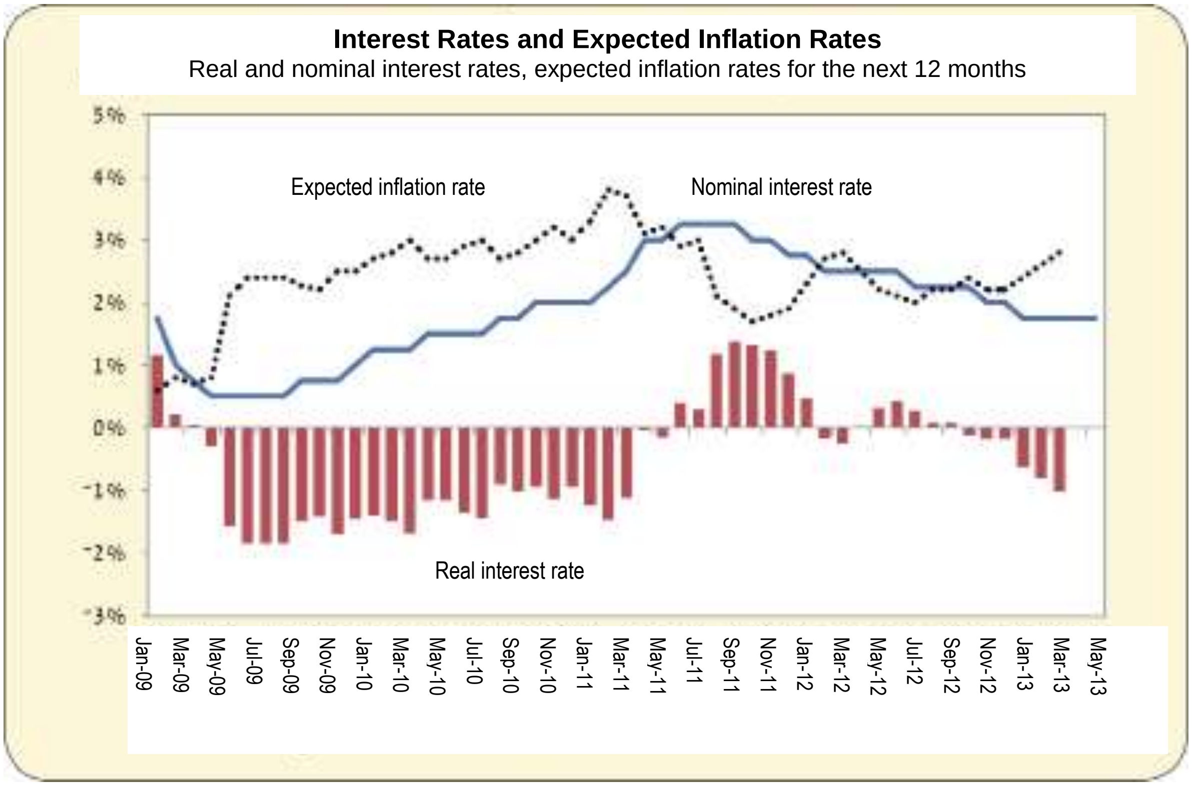
Inflation and Monetary Policy

Inflation in the Israeli economy in the first half of 2011 was higher than the government's inflation target, due, among other reasons, to the steep rise in prices of goods in general and in the prices of energy resources in particular, which forced the Bank of Israel to raise interest rates from 2.00% in December 2010 to 3.25% in June 2011. Inflationary pressures declined from the middle of 2011, and at the end of 2011 the annual inflation rate stood at 2.2%. The easing of inflationary pressures continued in 2012, during which the annual inflation rate was close to or below the center of the Bank of Israel's inflation target, reaching 1.6% at year end. The expected development in the inflation rates was similar to the actual development, starting above the inflation target in the first half of 2011 but subsequently falling to within the inflation target and stabilizing in 2012 close to the center of the target.



Source: Central Bureau of Statistics

The easing of inflationary pressures starting from the second half of 2011, following the stabilization of energy prices, enabled the Bank of Israel to respond to the slowing of economic activity by reducing its interest rate. Thus, the Bank of Israel reduced the interest rate from 3.25% in September 2011 to 1.75% in January 2013. Given the quantitative easing plans implemented in the world's leading economies, the interest rate cuts by central banks, led by the European Central Banks, and the continuing appreciation of the shekel (which adversely affects Israeli exports), the Bank of Israel decided in May to cut the interest rate to 1.25%.



Source: Bank of Israel, data processing by the Economic Research Department.

The negative real interest rate that prevailed in the economy from the start of 2009 until early 2011 contributed significantly to higher demand in the real estate market and to a surge in housing prices. In the wake of this surge (amounting to 73% from 2008 until February 2013), housing prices became a burning issue that affected the Bank of Israel's interest-rate decisions. The steps taken by the Bank of Israel (such as limiting the loan-to-value ratio) and by the government (such as granting a temporary tax exemption on sales of investment apartments) and the social protests in the summer of 2011 helped to moderate price increases, but from the middle of 2012 housing prices accelerated again (see diagram) following a return to negative real interest rates. Another factor boosting demand for apartments and apartment prices was the increase in tax on capital market gains at the beginning of 2012, which increased the tax-effective benefit of investments in the real estate market relative to the capital market.

Source: Bank of Israel, data processing by the Economic Research Department

The surge in housing prices resulted in significant growth in the volume of investments in private residential construction starting from 2010 (from 4.5% of GDP in 2009-2010 to 5.5% of GDP in 2011-2012) as well as a substantial increase in the number of housing starts (from 31,000 in 2007 to 45,000 in 2011). This uptrend ended in 2012, in which housing starts decreased to 40,000.

The increase in interest rates in the economy from the second half of 2009 until the middle of 2011 widened the gap between interest rates in Israel and the world, resulting in a massive inflow of capital to Israel and the appreciation of the shekel. In an attempt to counter the strengthening of the shekel, which adversely affected exports, the Bank of Israel and the Ministry of Finance took three steps: (1) the automatic exemption of foreign residents from capital gains tax was canceled; (2) foreign residents were required to report purchases of T-bills and derivatives; and (3) foreign residents were required to deposit 10% of their investments in Israel in local banks. This policy succeeded in significantly reducing the volume of short-term investments by foreigners, helping to halt the appreciation of the shekel. However, in recent months the shekel has been gaining again on expectations from the start of natural gas production. Concurrently with the reduction in the interest rate in May, the Bank of Israel announced that it would begin purchasing foreign currency in amounts that would offset the effects of natural gas production on the exchange rate up to the planned start of operations of the sovereign wealth fund in 2018.

Economic Policy and Budget Policy for Fiscal Years 2013-2014

This chapter presents the background for the state budget proposal for fiscal years 2013-2014, starting with a general analysis of the main challenges, threats and opportunities facing the Israeli economy in the coming years, and continuing with a discussion of the economic policy objectives. This is followed by five chapters dealing with the economic plan as reflected in the budget policy for 2013-2014.

The Israeli Economy: Strengths, Weaknesses, Threats and Opportunities

The Israeli economy presently stands at an important crossroads. At the end of a decade of structural reforms and growth-supporting macroeconomic policies, and after demonstrating an impressive ability to cope with the upheavals of the past decade and the global economic crisis, the Israeli economy is in a relatively good macroeconomic position. However, it is now facing a possible erosion of its economic gains and threats to its fiscal stability in the short term and its growth capacity in the long term.

Israel's economic strength is based on a longstanding tradition of structural reforms aimed at upgrading the economy, increasing competitiveness, reducing and streamlining public expenditure and promoting a responsible and growth-supporting fiscal policy. The many comprehensive reforms undergone by the Israeli economy – such as in the fields of taxation, government expenditure and public debt, labor market incentives, infrastructure, communications and public transport and in the capital, pension and savings market – as well as the measures taken to upgrade the economy and open it up to the global environment, have transformed it over the last decade into an open, competitive and more stable economy than in the past.

The Israeli economy also enjoys a distinct advantage in its human capital and high-tech industries. This advantage, along with the significant improvement in fiscal and monetary stability in the past decade, was a key factor in the rapid growth recorded by the economy from the end of 2003 until the onset of the crisis, its ability to cope with the security challenges of the past decade and its resilience in the midst of the global economic crisis. An indication of the strength of the Israeli economy is the high degree of confidence it enjoyed, and continues to enjoy, in the international markets, as evidenced by the volume of foreign investments in the economy, by Israel's credit rating and by its cost of funding.

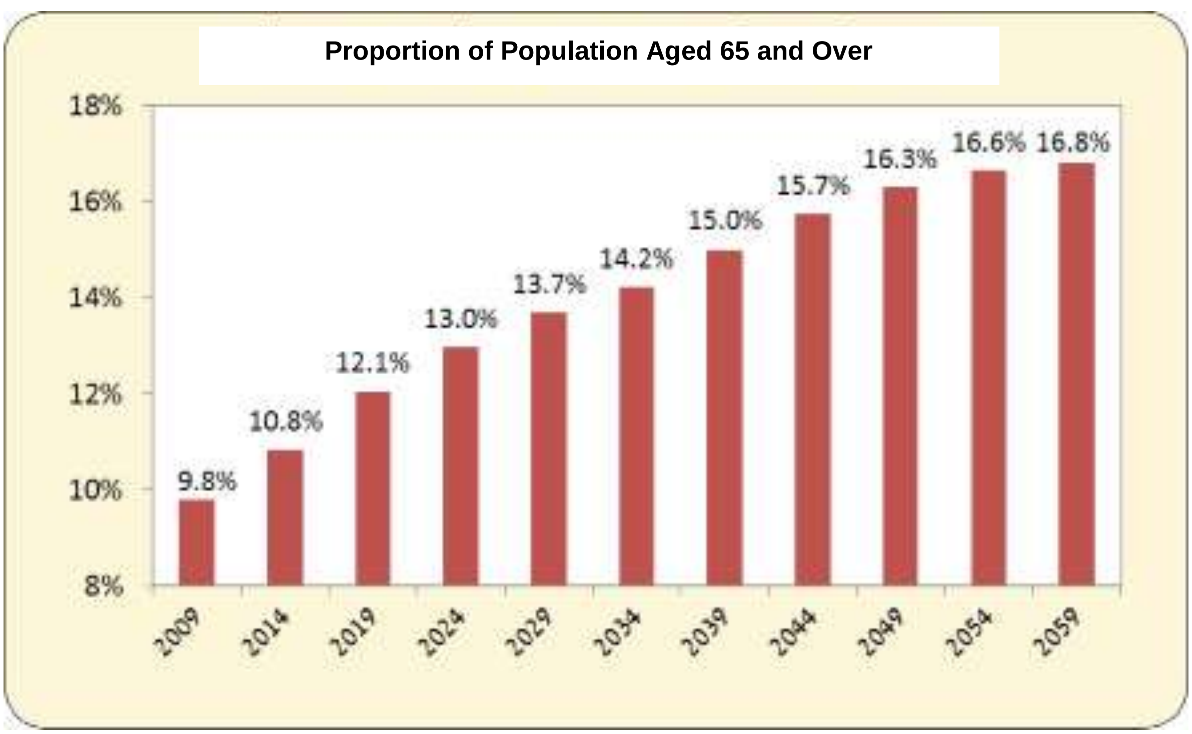
Despite the strengths enumerated above, there are significant signs of erosion in the advantages enjoyed by the economy and scenarios that threaten Israel's ability to grow if it persists in its "business as usual" attitude. Israel's fiscal discipline, one of its notable strengths prior to the crisis and an imperative condition for realizing the growth potential of its economy, has eroded in the past three years. This development calls for an immediate, fundamental and sustained change in fiscal policy, to avoid a rapid descent into a serious economic crisis. Therefore, a central objective of the state budget is to regain fiscal stability and discipline.

Apart from fiscal weakness, the state budget and the economic plan must deal with other salient weaknesses of the Israeli economy, among them the employment and labor productivity gaps between the different population sectors, which hinder growth and increase levels of poverty and inequality. Given the expected demographic developments, without a meaningful change in the state education system, including the teaching of basic skills in all sectors, and without a change in the employment rates and wage levels, the Israeli economy will be faced with a worrisome situation of consistent, significant growth in the percentage of the population that is unemployed or employed at a low wage due to low work productivity. This situation will necessitate increased public expenditure on transfer payments for the nonworking population, placing a growing tax burden on an ever-shrinking proportion of the population in order to finance these payments. Under such circumstances, the growth potential of the Israeli economy will be significantly impaired, a dynamic of intergenerational poverty will develop and the level of inequality will grow to an extent that calls into question Israel's ability to maintain a stable and sustainable socioeconomic system.

The limited competition and high concentration characterizing the Israeli economy stymie efficiency and innovation, affecting economic growth and pushing up the cost of living. Moreover, Israel's comparative advantage in human capital is steadily diminishing and the Israeli economy is suffering from infrastructure gaps, chief among them the ever-growing traffic congestion in the country's center and metropolises. These developments are affecting the country's overall productivity, making it essential to place them at the top of the budgetary priorities and to channel substantial resources to dealing with them. Other major weaknesses arise from the supply-demand gap in the land and property market and from tax distortions in this area, which directly impact housing prices, as well as excessive regulation and an inadequate level of public service due to bureaucratic inefficiency and inflexibility.

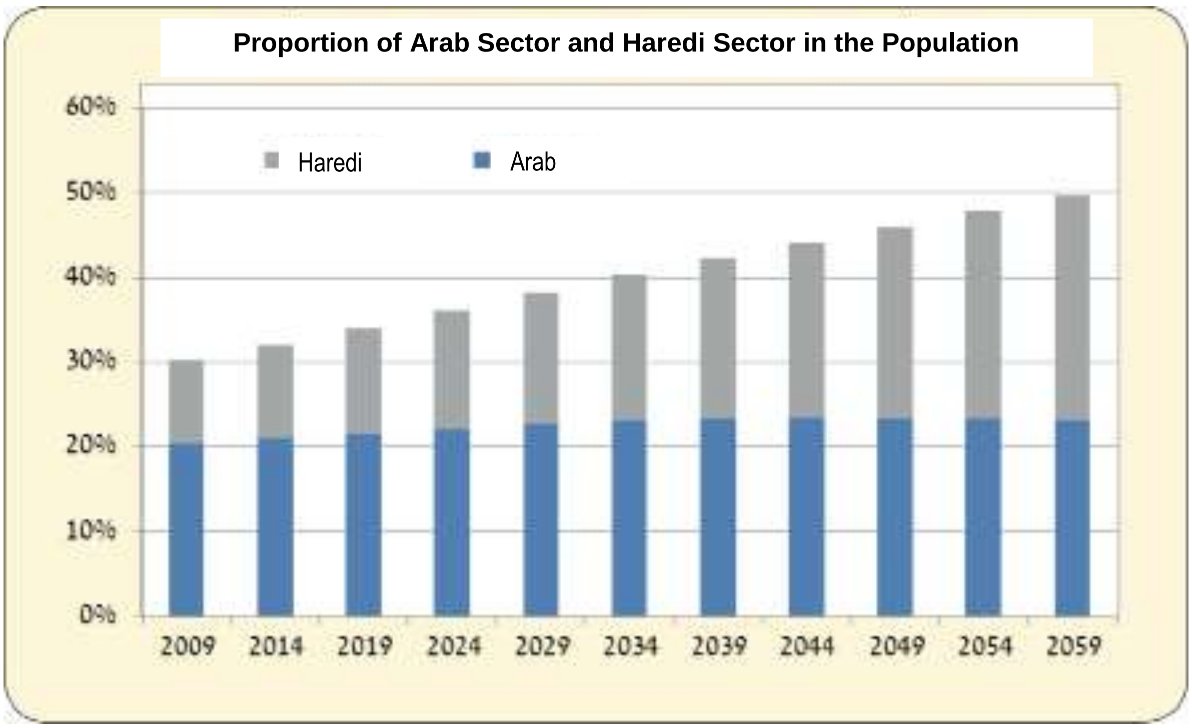
However, at the core of the weaknesses and threats are the demographic trends and their implications for Israel's economic growth potential, its future labor market, its long-term budgetary stability and the gaps in Israeli society. Three main demographic developments are foreseen in the coming decades:

Population aging process: According to the Central Bureau of Statistics demographic forecast (intermediate scenario), the coming decades will see a significant rise in the proportion of those aged 65 and over in the general population, from 9.8% in 2009 to 16.8% in 2059. The rapid growth in the population over retirement age is attributable mainly to two factors: a steady increase in life expectancy, and the current mass retirement of the generation that was born after World War II and the establishment of the State of Israel (the Baby-Boomer generation). This rise will significantly increase the elderly dependency ratio in Israel (the elderly dependency ratio is calculated as the population of those aged 65 and over divided by the population of those aged 15-64), from 11% in 2010 to 16% in 2030 and 20% in 2050. The graying of the population is expected, among other things, to slow economic growth and significantly boost public expenditure, which is affected by the size of the elderly population in such areas as health and transfer payments.



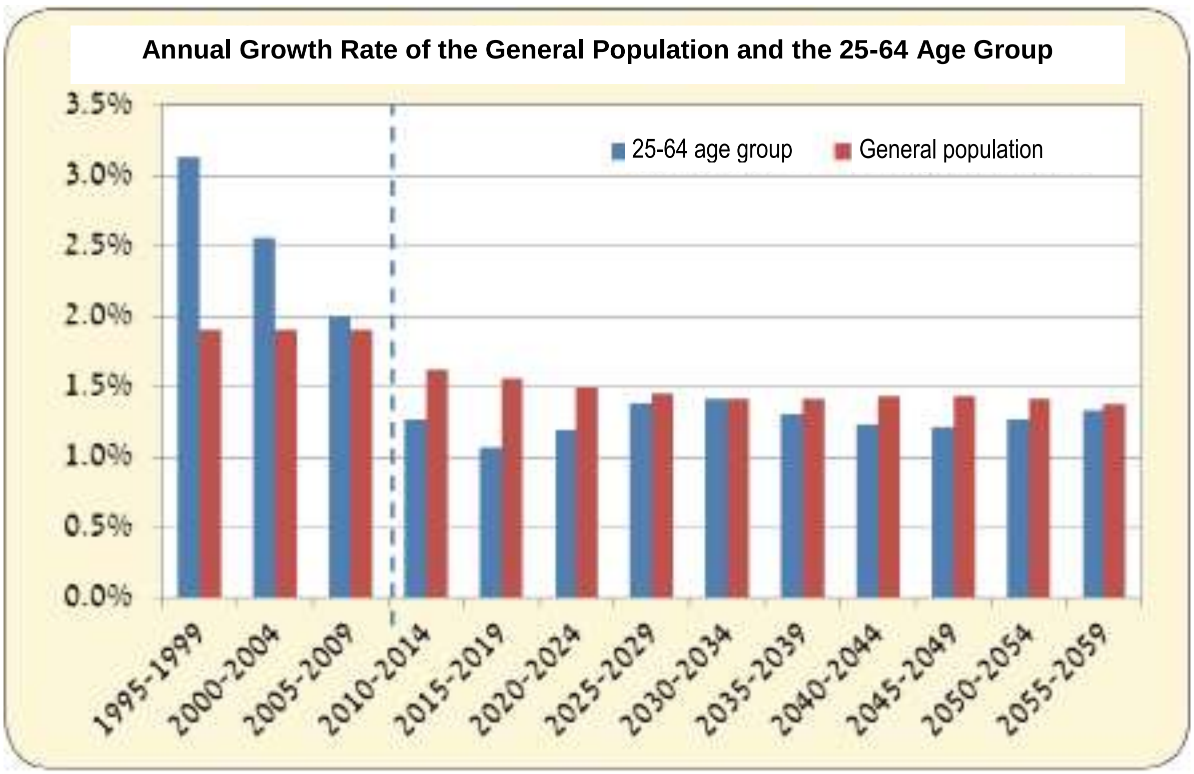
Source: Central Bureau of Statistics

Change in population composition: In the coming decades a significant change is expected in the proportion of key population sectors, resulting in a reduction in the labor participation rate. According to Central Bureau of Statistics forecasts, the proportion of the non-Haredi Jewish population is expected to fall from 69.7% in 2009 to 50.3% in 2059, mainly due to the projected increase in those years in the proportion of the Haredi population, from 9.9% to 26.6%, as well as in the proportion of the Arab population, from 20.3% to 23.1%. The growth in the percentage of these population segments, which have a low rate of participation in the labor market and relatively low work productivity, is liable, in the absence of suitable policy measures, to lead to slower growth and greater inequality and poverty.



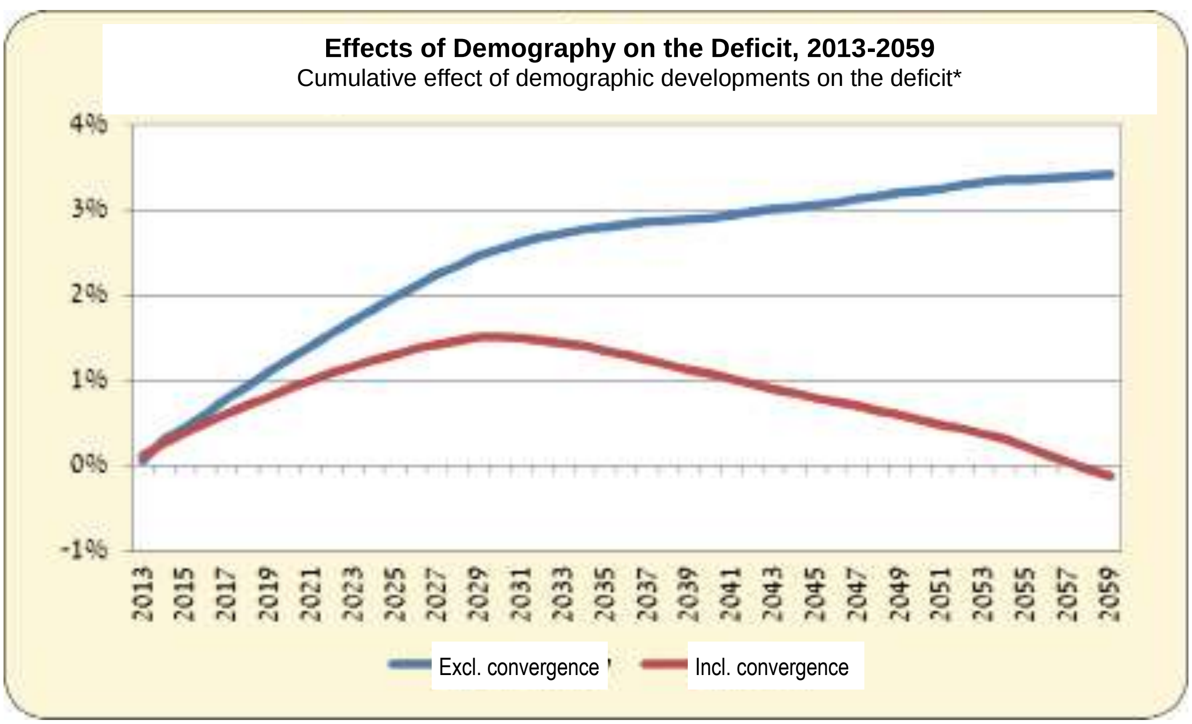
Source: Central Bureau of Statistics

Decrease in the growth rate of the main working-age group: In recent years the main working-age group (ages 25-64) grew at a significantly faster rate than the general population, resulting in accelerated growth in this period. In the coming decades this trend is expected to reverse, with the main working-aging group projected to grow at a slower rate than the general population. This development will impact negatively on the GDP growth rate already in the next decade (the growth potential of the economy in the next two decades will be 1% lower compared to the past 15 years, due solely to the slower growth rate of the working-age sector, without taking into consideration changes in the sectoral composition of the population).



Source: Central Bureau of Statistics

The demographic developments discussed above have broad economic, social and fiscal implications. Beyond this, these developments increase the importance of fully integrating the Arab sector and the Haredi sector into the labor market, in terms of employment rates and output per worker. According to calculations of the Ministry of Finance's Economic Research Department, growth in the coming decade will achieve an annual average rate of 2.8% in a scenario of convergence of the Arab and Haredi sectors in the labor market, compared to average growth of only 2.6% in a scenario of non-convergence of these sectors. Furthermore, in the absence of convergence in the work patterns of the Arab and Haredi sectors in the labor market, the budget deficit is expected to grow, causing divergence of Israel's debt-to-GDP ratio, as opposed to a scenario of convergence in the labor market. It should be noted that divergence in the debt-to-GDP ratio would mean an inevitable economic crisis necessitating extremely painful fiscal measures. Therefore, the longer this challenge is left unaddressed, the greater will be the social and economic cost of treating it. A meaningful step towards dealing with this challenge is the advancement of the plan for equal sharing of national service obligations and the economic burden.



* Deficit of the general government. Excluding the effect of an increase in interest payments due to higher debt.

Source: Calculations of the Economic Research Department.

There are various means that can be employed to improve long-term budgetary stability and ensure a sustainable fiscal policy, that is – ensuring the government's ability to finance its current and future obligations without constantly increasing the tax burden, maintaining economic growth over time and providing in the future public services and subsidies on a par with those provided today, i.e. preserving intergenerational equity.

A key means for contending with projected budgetary needs is the freeing up of internal budget resources, such as public-debt reduction. Such a measure will enable financing future budgetary expenditures without raising the tax burden. Maintaining a long-term downward debt trajectory, for instance, will augment budgetary stability and credibility, allowing the Israeli economy greater latitude to tackle future economic crises. Said action will enable reducing interest costs that eat away a significant chunk of the budget and freeing up these budgets for other needs, such as reducing social gaps and improving education.

Other examples of the freeing up of resources are reducing the share of defense expenditures in the budget, managing wage expenditure levels in the government and public sectors and keeping National Insurance transfer payments at levels sustainable over time.

Besides all the foregoing, at present there is a great degree of uncertainty concerning developments in the global economy, which have a real impact on Israel – a small and open economy. In addition, Israel's unique geopolitical situation only heightens this uncertainty. Hence, both these factors require policymakers to pursue a responsible policy that will allow a wide compass of action and flexibility in responding to negative developments.

The continued development of Israel's economic growth engines and reinforcement of its advantages could prevent the erosion of its economic gains and even steer the country onto a track of high and sustainable growth. However, a "business as usual" attitude in the face of the anticipated demographic trends and their impact on Israel's labor market and human capital could lead to real slowing of the growth rate and widening of the social gaps. This analysis of the Israeli economy, which explores several key development scenarios, forms the basis of the economic policy and the state budget for 2013-2014, as set out below.

Economic Policy Objectives

The key objectives underlying the state budget for 2013-2014 and the accompanying economic plan are: placing the working individual at the center of the economic ethos, increasing growth rates, integrating additional population sectors in the labor market and reducing social gaps. Fiscal stability is an imperative condition for realizing these objectives. Thus, considering the weakening of Israel's fiscal position, the state budget contains a series of measures for fiscal stabilization, including reduction of the structural deficit to 3% of the GDP in 2014 and adjustment of government expenditures to the expenditure ceiling set in the law. Apart from achieving fiscal stabilization and getting the economy back on a sustainable footing, the state budget and the economic plan include budgetary additions and various reforms for dealing with the challenges facing the Israeli economy and society, while additional reforms will also be promoted separately from the budgetary process. Based on the key objectives, the following three policy objectives were defined:

- Implementing a responsible fiscal policy for strengthening economic stability.
- Increasing per-capita GDP, expanding employment and raising the level of productivity in the economy.
- Increasing competitiveness, reducing the cost of living and improving public sector efficiency.

Chapters of the Economic Plan

To attain these objectives, an economic plan has been drawn up comprising five main chapters:

Chapter 1 – Responsible Fiscal Policy

Strengthening Israel's fiscal stability and maintaining government credibility are imperative for realizing the objectives of the economic plan. In this context, and in accordance with the amendment to the Deficit Reduction and Budgetary Expenditure Limitation Law adopted by the government and the Knesset, a series of measures is proposed for the convergence of the recent years' uncontrolled growth in budgetary obligations within the expenditure limit set in the law, along with the adjustment of the deficit to the statutory ceiling. Owing to the delay in the approval of the state budget for 2013, the effects of the proposed measures will be reflected only partially in this budget year. The full range of the proposed measures, both on the expenditure side and on the revenue side, will be fully reflected in the 2014 budget year, in which there will be full compliance with the fiscal rule for calculating the central government expenditure ceiling and a return of the budgetary deficit to a decreasing trajectory, enabling the strengthening of Israel's fiscal stability and a reduction in the debt-to-GDP ratio.

Chapter 2 – Increasing Workforce Participation Rates

This chapter presents a nationwide welfare-to-work plan ("Yotz'im La'avoda") for the occupational integration of the chronically unemployed who must overcome complex barriers to join the workforce, concurrently with other proactive steps that are being taken in the labor market. In addition, measures are proposed for encouraging the employment of both spouses in a family.

Chapter 3 – Raising the Productivity Level in the Israeli Economy

This chapter details a list of tools that are essential for raising the level of productivity in the Israeli economy in the medium and long term. These tools include significant budgetary additions in the field of education, the improvement of education for work skills, including through augmented teaching of core subjects in all educational institutions, the continued allocation of resources to the higher education system in accordance with the multiannual plan, large investments in the transport sector and the removal of barriers to the development of mass transit systems, the promotion of the life sciences industry by improving the interface between the industry and the regulatory bodies, and the strengthening of economic ties with China, India and Brazil in the area of high-tech industries.

Chapter 4 – Increasing Competitiveness and Reducing the Cost of Living

This chapter proposes measures for increasing competitiveness and reducing the cost of living, including measures in the communications market, improvement of the national standards policy and implementation of the Food Committee's recommendations as well as the recommendations of the Committee on Concentration in the Economy.

Chapter 5 – Increasing Public-Sector Efficiency

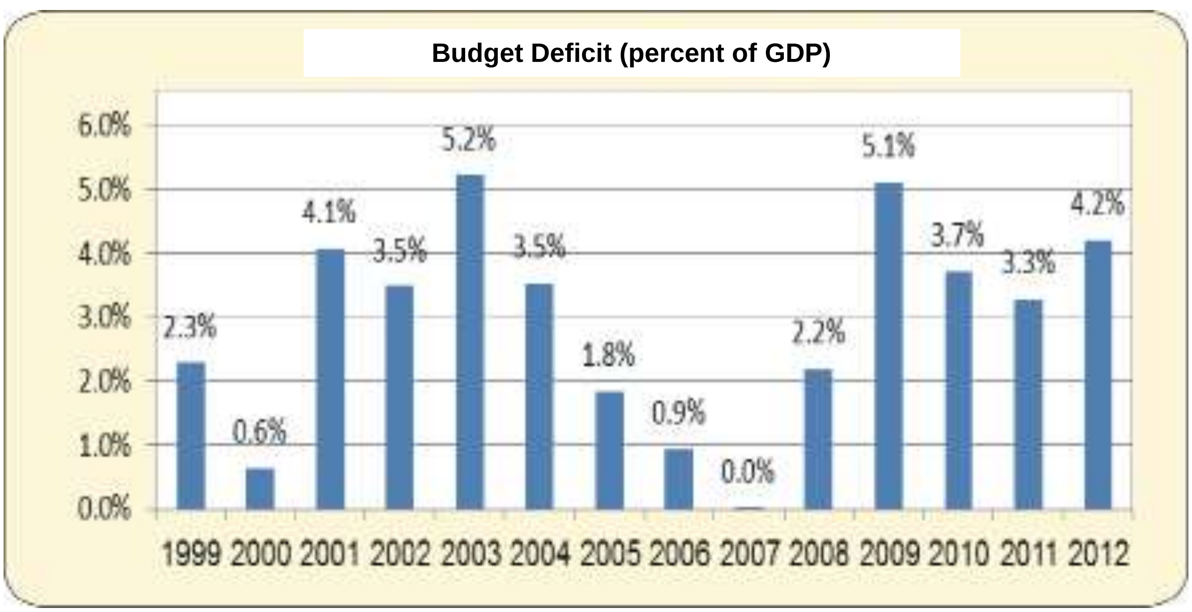
This chapter includes reforms aimed at increasing the work efficiency of the public sector, relating inter alia to the work of various public bodies.

Chapter 1 – Responsible Fiscal Policy

Economic-Fiscal Overview

The Israeli economy weathered the global economic crisis of 2008-2009 relatively well. One of the key factors contributing to the rapid recovery from the crisis was the strong fiscal stability of the economy immediately before the outbreak of the crisis.

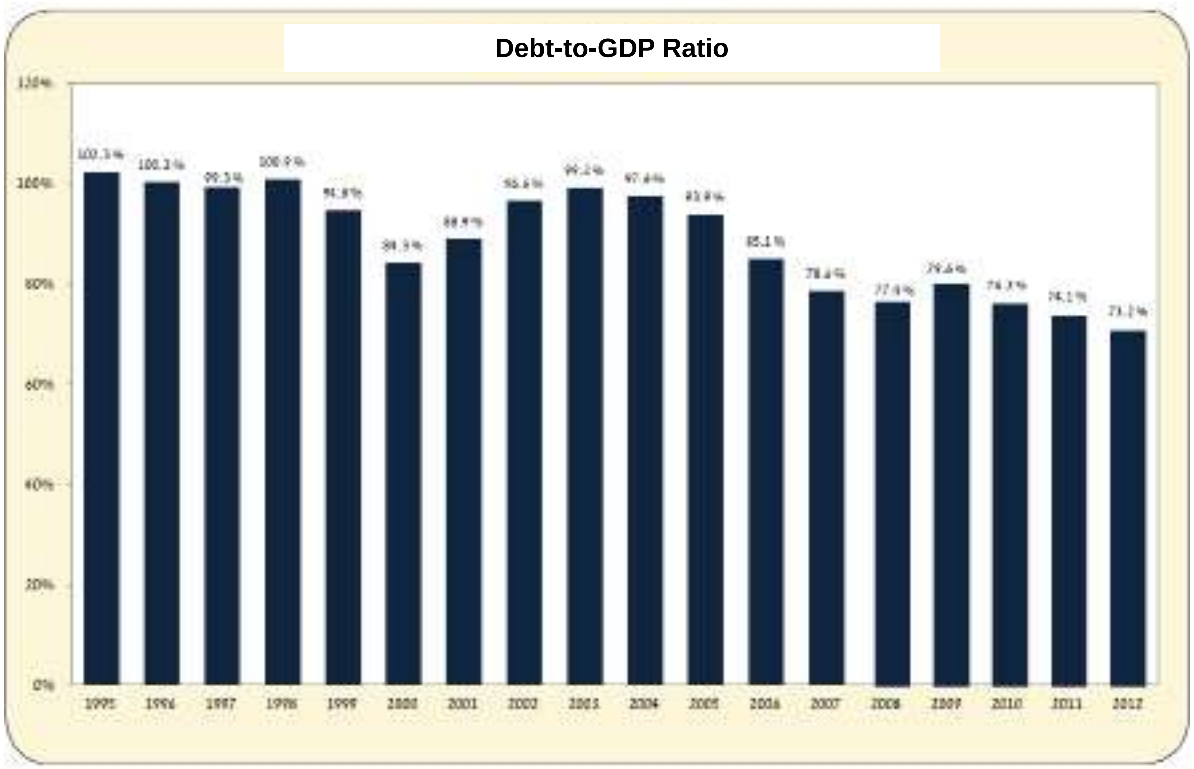
Despite the economy's positive macroeconomic data, recent years have seen a significant erosion in Israel's fiscal stability. The budget deficit in 2012 amounted to 4.2% of GDP, significantly above the deficit ceiling on which the planning of the state budget for that year was based. This means that notwithstanding the rapid recovery from the crisis and the high growth recorded in 2010-2011, Israel has passed through four consecutive years of a high budget deficit exceeding 3% of GDP, a level that will hinder the government's ability to respond in the event of another economic crisis. Furthermore, the fact that the economy is nearly at full employment capacity is evidence of the absence of an output gap, and therefore the existing budget deficit reflects a high structural deficit rather than a deficit due to a negative business cycle.



Source: Central Bureau of Statistics and Ministry of Finance.

Concurrently, over the past few years the government and the Knesset approved a long series of measures that created especially large budgetary obligations. As a result, although the permitted increase in expenditure in the state budget for 2013-2014 is higher than in the past, the government will still need to make significant adjustments on the expenditure side. All these developments together necessitate an immediate, fundamental and sustained change in fiscal policy and budgetary priorities, otherwise the economy is likely to tailspin into a serious crisis.

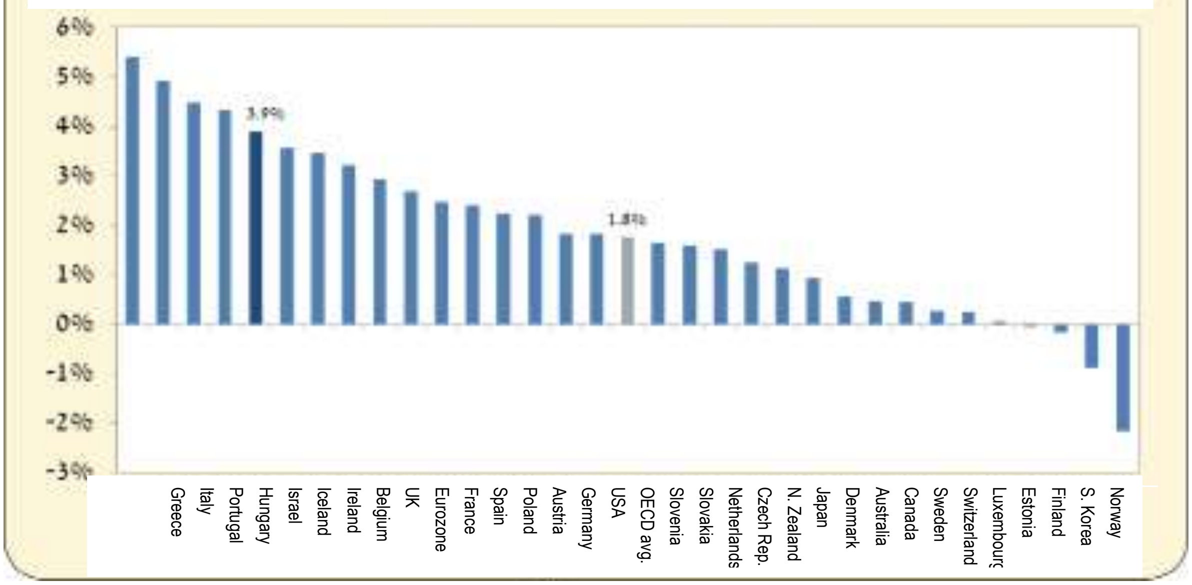
The public-debt-to-GDP ratio, which is a key indicator for assessing fiscal stability and the state's future debt repayment ability, stood at the end of 2012 at a high 73.2% (down one percentage point from 2011).



Source: Central Bureau of Statistics, Bank of Israel and Ministry of Finance.

It should be borne in mind that in spite of the improvement in Israel's fiscal stability since the middle of the last decade, and although Israel has never declared a debt moratorium, its funding costs remain much higher than those of countries considered safe, due, among other reasons, to a high geopolitical risk premium. It should be noted, however, that Israel's present funding costs are lower than in the past, among other reasons due to a decline in yields and quantitative expansions implemented around the world.

Interest Payments as a Percent of GDP, International Comparison for 2012



Source: OECD

Continuing divergence from the fiscal targets will ultimately impair the government's budgetary credibility, raise the financing costs of the public and business sectors, impede economic growth and harm the public welfare. Moreover, Israel, as a small, open and geopolitically vulnerable economy, is highly sensitive to external and domestic upheavals. In the event of an economic upheaval, the government's hands will be tied, possibly sending Israel into a fiscal and financial crisis that would necessitate taking extreme and painful measures on a much wider scale than if they had been implemented before the crisis. Accordingly, the fiscal consolidation is a cornerstone of the economic plan for 2013-2014.

Principles of the Budget Policy

The state budget for 2013-2014 is set to grow, in accordance with the fiscal rule, at especially high rates, in spite of which the backlog of government obligations will necessitate making considerable adjustments. Therefore, the composition and manner of implementation of the budget will impact strongly on Israel's economic stability and future economic growth and on the scope of the services provided by the state to its citizens. Accordingly, the budget bill and the economic plan address three aspects:

- Stability – Making adjustments both on the expenditure side and on the revenue side on a scope that will enable convergence within the fiscal rules established in the law, in order to reinforce budgetary stability and maintain the credibility of the government's fiscal policy, which are essential for economic growth and for bolstering the economy's resistance to future external and domestic upheavals.
- Prioritization – Allocating the budgetary additions in accordance with the economic policy objectives and making the necessary adjustments in the most economically and socially appropriate manner, while also examining the effects of the decisions on the state budget in the medium term.
- Reforms – Advancing economic reforms that accompany and complement the budgetary policy, in order to strengthen growth and improve the public welfare.

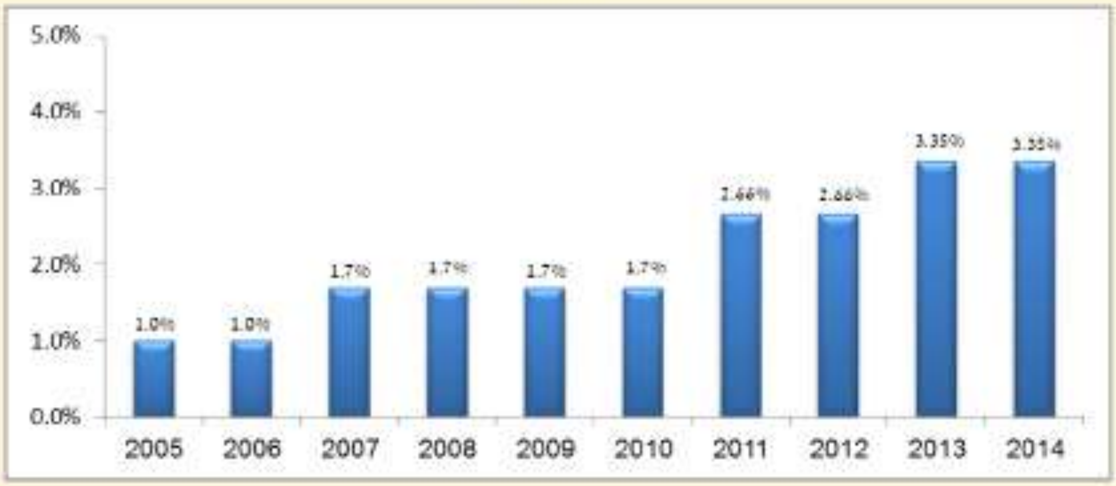
Convergence within Fiscal Frameworks

The budgetary expenditure for 2013 for calculating the expenditure limit stands at NIS 309.5 billion. In accordance with the fiscal rule, the real increase in the budgetary expenditure for 2013 is 7% relative to the 2012 budget. This real increase consists of an addition of NIS 9.5 billion (based on the expenditure rule), an addition of NIS 3.8 billion for adjusting the budget to 2012 prices, and a one-time addition of NIS 6.5 billion.

The deficit for 2013 is forecast at 4.65% of GDP, assuming 3.8% growth (the nominal GDP forecast for 2013 is NIS 987.7 billion).

The budgetary expenditure for 2014 for calculating the expenditure limit stands at NIS 320.3 billion, representing, in accordance with the fiscal rule, a real increase of 3.35% relative to the 2013 budget net of the one-time expenditure added in 2013. The deficit for 2014 is forecast at 3% of GDP, assuming 3.3% growth (the nominal GDP for 2014 is forecast at NIS 1,037.8 billion).

Permitted Real Growth in Government Expenditure per the Fiscal Rule, 2005-2014*



* Excluding one-time additions

According to the revenue forecast, which is derived from the current tax regime, in 2013-2014 a significant shortfall is foreseen in state revenues below the revenue needed to meet the deficit ceiling. Furthermore, in recent years the government assumed extensive budgetary obligations, which are added to the natural growth in the budget and to budget-related legislative amendments that were passed by the Knesset. Hence, in the absence of adjustments, the increase in the government expenditure arising from the government's obligations for 2013-2014 would significantly surpass the expenditure limit permitted by law.

Thus, in order to stay within the permitted increase in the budgetary expenditure and the deficit ceiling, the government must make large-scale adjustments in 2013-2014 both on the expenditure side and on the revenue side.

For the purpose of formulating recommendations for the proposed adjustments on the expenditure and revenue sides, while taking feasibility considerations into account, various parameters were examined, such as economic efficiency, contribution to growth, contribution to strengthening weak population sectors and reducing gaps, and contribution to correcting distortions in the allocation of resources in the economy. However, given the importance of achieving fiscal stabilization and the extent of the adjustments required for this purpose, the government will be required to take measures that do not fully conform to the parameters mentioned above.

The key measures on the expenditure side are: correcting distortions and improving efficiency; freezing wage increases in the public sector (on a scope of NIS 0.5 billion and NIS 1 billion in 2013 and 2014 respectively); reducing the defense budget (on a scope of NIS 3 billion in 2014); cutting child allowances and other adjustments to National Insurance Institute expenditures and revenues (on a scope of NIS 3.4 billion in 2014); postponing infrastructure projects (on a scope of NIS 1.5 billion in 2014), and cancelling some of the additions to the education budget (on a scope of NIS 1.5 billion in 2014).

Notwithstanding the required adjustments, the state budget will increase in 2014 relative to the 2012 budget by more than 8% in real terms – the highest real rate of increase in the past decade. The notable increases in the state budget for 2013-2014, determined based on the government's priorities, include the following: increase in the budget of the Ministry of Education (by NIS 9.1 billion in the 2014 budget year relative to the 2012 budget year); increase in the transportation budget (by NIS 4.7 billion in the 2014 budget year relative to the 2012 budget year); increase in the budget of the Ministry of Public Security (by NIS 2.9 billion in the 2014 budget year relative to the 2012 budget year); increase in the higher education budget (by NIS 1.7 billion in the 2014 budget year relative to the 2012 budget year).

The key measures proposed on the state revenue side are: raising of income tax by 1.5% beginning in 2014, putting the top marginal income tax rate at 49.5%; raising of VAT by 1%, to stand at 18%; raising of corporate tax by 1.5% beginning in 2014, to stand at 26.5%; cutting of tax exemptions; simplification of the mechanism for taxing pension contributions and reduction of the benefit for the top decimal; raising of taxes on cigarettes and alcohol; imposition of additional taxes in the housing sector.

All these measures should cause the state budget in 2014 to converge within responsible fiscal limits, bringing it within the expenditure limit for that year and putting the budget deficit at 3% of GDP.

However, owing to the delay in approval of the state budget for 2013 and the government's limited ability, for this reason, to make the necessary adjustments to its expenditures and revenues, it was determined that apart from the permitted growth in expenditure in accordance with the law, the government will be allowed to increase its expenditures on a one-time basis in the 2013 fiscal year beyond the rate established in the law, by no more than 2.2% of the amount of the government expenditure in 2012. In addition, the budget deficit reduction trajectory was changed such that the deficit ceiling for fiscal year 2013 may not exceed 4.65%.

Expansion of the Tax Base and Reduction of the Tax Burden on the General Population

Tax collection in Israel is the main source of state revenues. The manner in which assessments and audits are conducted and collection is enforced directly affect state revenues.

In recent years, public revenues were found to have eroded due to the proliferation of such phenomena as money laundering, tax evasion and improper use of aggressive tax planning that takes advantage of loopholes and gray areas in tax law in order to claim entitlement to tax benefits contrary to the spirit of the law and the legislator's intention. In other words, there is a considerable gap between the reported economic activity and the actual economic activity (hereinafter – "black economy").

Therefore, in addition to expanding the tax base through the cancellation of exemptions, great importance attaches to strengthening enforcement and dealing with Israel's black economy. Reducing the gap between reported activity and actual activity, along with more effective enforcement, should significantly expand the tax base in Israel, thereby increasing the government's resources as well as creating a more just and equitable tax system by reducing the competitive advantage enjoyed by tax-evading businesses over law-abiding businesses.

Accordingly, the Ministry of Finance promoted in July 2012 government resolutions relating to money laundering and black capital in the framework of illegal economic activity as well as legal economic activity involving tax evasion, as well as enforcement of tax laws, improvements in the transfer of information to the tax authorities and greater efficiency in tax collection.

The economic plan also seeks to deal with structural tax problems, so as to achieve a just distribution of taxes and minimize impediments to tax collection that harm the tax-paying middle class.

Measures to increase enforcement and contend with the black economy, as proposed in the economic plan, are expected to add NIS 2 billion to state revenues. Intensification of the war against black capital and money laundering will result in increased tax collection in both the short and the long term, while creating a fair distribution of the tax burden among the entire population. Reducing the gap between reported activity and actual activity will also help government efforts to meet the expenditure limit and the deficit ceiling without having to raise the statutory tax rates by higher rates than those proposed.

Chapter 2 – Increasing Participation Rates in the Workforce

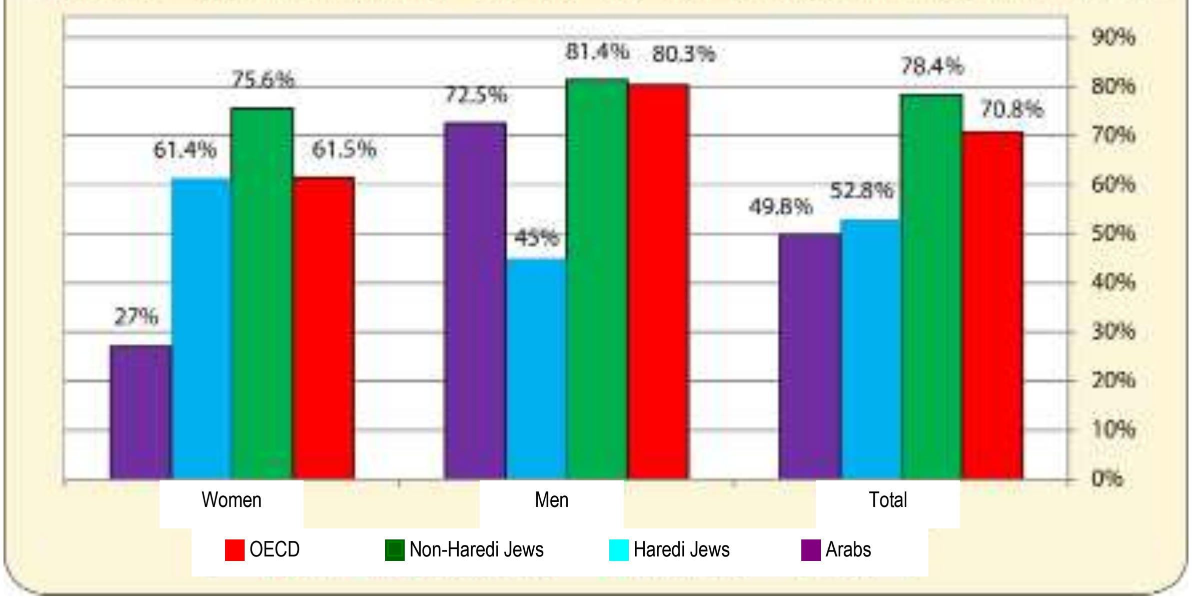
Background and Problem

In 2012 the number of employed persons in the economy reached 3.4 million. The employment rate for ages 15 and over stood at 54.2%, and for ages 25-64 at 74%. The last decade saw a steady rise in employment rates (for ages 25-64), from 66.9% in 2000 to 70% in 2007, 72.1% in 2011 and 74% in 2012 (owing to methodological changes introduced by the Central Bureau of Statistics, there are problems in a multiannual comparison of these figures), simultaneously with a strong decline in the unemployment rate, from 13.6% in 2003 to 7% in 2011 and 6.9% in 2012. In these years the labor market grew at significant rates, and the expansion in economic activity enabled almost full employment. In 2009 there was a temporary upswing in the unemployment rate due to the global economic crisis, however the labor market recovered rapidly, achieving, as noted, an unemployment rate of 6.9% in 2012, accompanied by a significant increase in the number of employed persons in the economy.

In spite of the improvement in recent years in the labor market, the employments gaps between the different population sectors have widened and the number of nonparticipants in the labor market remains high, constituting one of the fundamental problems of the Israeli economy.

Added to this are concerns over a future decline in participation rates due to accelerated demographic growth in population sectors with low participation rates in the workforce. As shown in the diagram below, the population of Haredi (ultra-Orthodox) men (45% employment rate among the 25-64 age group in 2011) and the population of Arab women (27% employment rate among the 25-64 age group in 2011) are characterized by significantly lower participation and employment rates than other population groups in Israel and compared to accepted levels in the OECD countries.

Employment Rates in the 25-64 Age Group by Population Sectors, 2011



Source: Central Bureau of Statistics and processed data of the Bank of Israel, 2011.

Policy Objectives

To promote government handling of the labor market and boost employment rates in the different sectors, the Committee to Examine Employment Policy was established in 2009, headed by the then Deputy Governor of the Bank of Israel, Prof. Zvi Eckstein ("the Eckstein committee"). The Eckstein committee recommended setting high long-term employment goals, with a view to narrowing gaps and realizing the economy's full growth potential. The committee also recommended a series of steps for achieving these goals, including the promotion of structural changes and implementation of plans aimed at encouraging the employment of Israelis, while focusing on low-participation populations.

The object of these employment goals is to reach employment levels on a par with the world's developed countries, and to add 33,000 workers a year beyond the number of workers added due to natural increase of the population. This addition to the number of workers is consistent with a rise of 0.5%-1% in the annual GDP growth rate (or an annual GDP increase of NIS 3.75-7.5 billion), making this one of the most significant growth engines of the Israeli economy.

The employment goals subsume sub-goals, including those specifically targeting low-participation populations, and they provide for the following distribution of the added number of workers by type of population: 42% newly employed persons in the minorities sector and in the Haredi sector, 11% persons with disabilities, and 46% persons from the rest of the population (by boosting the participation rate, reducing the unemployment rate and increasing employment among various population groups such as Ethiopian and Russian immigrants, residents of peripheral communities and recipients of subsistence allowances in the working age group).

It should be noted that the employment goals set by the Eckstein committee, which were adopted by the government in Resolution No. 1994 from July 15, 2010, are ambitious and challenging goals, necessitating the implementation of far-reaching and complex structural changes in the labor market. Without such changes, and without the promotion of focused plans for encouraging the employment of low-participation populations and making employment participation more worthwhile than the alternative of nonparticipation, it will not be possible to achieve these goals and to reach the per-capita GDP levels of the 15 most developed countries.

It is important to note that given the accelerated demographic growth in populations with relatively low employment participation, if each population group maintains its present employment rate, by 2020 the overall employment rate will decrease by 2%, significantly affecting the GDP. In other words, in view of the above demographic trends, the alternative is not fixation at the present employment rates but rather a significant decline in employment rates, with a resulting drop in the per-capita GDP, accompanied by significant widening of social gaps and inequalities. Increasing the rate of participation in the labor market, especially among populations with low participation, is a major tool for strengthening economic growth as well as reducing poverty and narrowing gaps. To illustrate, the incidence of poverty in Israel among households with two wage earners or more stands at less than 5%, compared to over 70% among households with no wage earner.

Accordingly, the structural changes in the labor market, which form part of the economic policy outlined for 2013-2014, are essential for realizing the economy's growth potential, and their full implementation will facilitate meeting the employment goals that were set and reaching the per-capita GDP levels of the 15 countries with the highest per-capita GDP.

Policy Measures

As discussed above, achieving the employment goals entails the promotion of policy measures and substantive structural changes in the labor market.

Below is a brief overview of the government's proactive policy in the area of employment, which has been partially implemented in recent years and will continue to be implemented as part of the economic plan for 2013-2014.

"Yotzim La'avoda" Welfare-to-Work Plan

The population of welfare recipients consists of the chronically unemployed who are prevented from joining the job market by complex barriers that cause poverty, including intergenerational transmission of poverty. The employment integration of this population requires a significant investment in providing work-support services, including the gradual conversion of assistance from the payment of allowances to promoting employment prospects and removing barriers, in parallel with the institution of an effective employment test for welfare recipients aimed at ensuring their integration in employment. It should be noted that similar plans for integration in the job market are implemented in one format or another in the majority of developed countries.

In view of the specialized and focused approach needed for dealing with this population, the government decided on the nationwide deployment of a plan for integration into work, called "Yotzim La'avoda" ("Going out to Work"). Implementation of the plan will enable this population to realize its earning capacity, by providing meaningful job-placement support tools. It will thus be instrumental in focusing the social welfare network on the population in need of it and will directly facilitate an increase in employment rates and workforce participation.

Realization of Earning Capacity

The government decided to institute an effective earning-capacity test for child day-care subsidization, that is, it decided that the employment test used for subsidizing the cost of children's day-care centers will be applied to both heads-of-household, on a gradual and proportional basis over a period of four years, taking military and national service into account as employment. Yeshiva studies will also be recognized as satisfying the employment test, as long as the yeshiva student is legally entitled to a deferral of service granted by the Ministry of Defense (during the first years of his yeshiva studies or while in the "diligent students" track included in the plan for equal sharing of the military/national service obligation). This measure is intended to increase the rate of employment of both heads-of-household and is one of a series of steps that are being taken by the government to achieve its goal of increasing the participation rate and providing focused help to the working individual.

The government also decided to institute an earning-capacity test for granting a discount on municipal property tax, which sets a threshold employment rate of 125% for both spouses (and a lower rate for individuals and students) as a condition for eligibility for an income-based discount.

Other Proactive Labor Policy Measures

Other steps taken by the government as part of its proactive policy in the labor market include the following: implementation of five government resolutions relating to the promotion of employment among the Arab population and realization of the economic potential of this sector; implementation of plans and tools for encouraging employment among the Haredi population; nationwide deployment of a plan for income grants (negative income tax) for low-wage earners starting from the 2011 tax year, and increasing the grant for working mothers by 50% starting from the 2012 tax year; widening the supply of supervised and subsidized day-care centers, as part of the government's policy of removing barriers to employment, so as to encourage parents of young children to go out to work and increase employment of both spouses in a family; change in the regulatory structure in the area of employment, including the establishment of an employment administration headed by the Employment Commissioner at the Ministry of Economy; increasing the efficiency of the professional training system by expanding the use of professional training vouchers and workplace training procedures.

Long-Term Care Allowance for Employers of Foreign Workers

The National Insurance Institute's long-term care benefit for the elderly is currently provided through caregiver agencies that are under contract to the National Insurance Institute to provide long-term care services for the elderly as defined in the law. Also in cases where an elderly person requiring long-term care employs a foreign worker, the long-term care benefit is paid to a caregiver agency, which participates with the elderly person in paying for the employment of the foreign worker.

When caregiver agencies provide services to elderly people through a local (non-foreign) worker, this entails extensive work in handling the caregiver placement process and providing the services, reflected in the tariff paid to these agencies which includes also overheads. In contrast, when the caregiver is a foreign worker, the services provided by the caregiver agency are negligible, since, by law, foreign workers in the long-term care sector are hired by foreign-worker brokerage and placement agencies which are responsible for brokerage, regular supervision, assistance in drawing up employment contracts, assistance in settling the employer's debts in accordance with the law, etc.. Therefore, the costs incurred by long-term care agencies in the employment of foreign caregivers are significantly lower, securing them a higher profit than when the service is provided by Israeli workers. This creates a built-in economic incentive for caregiver agencies to increase the employment of foreign workers and reduces the incentive to improve the long-term care services provided by Israeli workers.

In April 2013 an experimental program operated by the National Insurance Institute from March 2008 under a temporary order ended. In the framework of this program, persons entitled to long-term care benefits were given the option to receive the benefit in the form of money instead of as a service provided through a caregiver agency (benefit in kind). The experimental program was accompanied by a study of the Center for Research on Aging at the Brookdale Institute, which examined a broad range of subjects, including satisfaction of the elderly care recipient, the care provided by family members and the burden imposed on them, the bureaucratic processes involved, various aspects of the caregiver hiring process and the caregiver's employment conditions. The preponderant majority (85%) of elderly persons who opted to receive the benefit in the form of money, had previously received the long-care benefit through a caregiver agency, and their relatives were asked to report changes that occurred following the switch to a monetary benefit.

Ninety-eight percent of elderly people who received a monetary benefit reported that they were satisfied with it, 97% recommended implementing the program on a permanent basis nationwide, and 77% said that the switch to a monetary benefit had saved them money for paying the foreign caregiver. It is apparent from the study that in all the parameters examined, the recipients of the benefit in the form of money were satisfied more or the same as recipients of the benefit in kind. In addition, the study showed that the financial savings for an elderly person who switched to a monetary benefit ranges between NIS 400 and NIS 600 per month.

To ensure that the budgets allocated by the state for providing care to elderly long-term care patients reach their destination in entirety, without the involvement of unnecessary middlemen who add cost without value, and for the purpose of improving the services provided by local workers in the caregiver industry and encouraging wider employment of Israelis in this industry, it is proposed in the economic plan that the National Insurance Institute pay the long-term care benefit directly to the entitled person, instead of through caregiver agencies. In addition, it is proposed to put in place additional measures that will make it easier for elderly long-term care patients who employ foreign caregivers to meet their legal obligations as employers with respect to National Insurance and health insurance payments.

Chapter 3 – Raising the Productivity Level in the Israeli Economy

Education

Education is key to narrowing gaps, developing human capital and creating job opportunities which are essential for sustained growth. Studies conducted in Israel and abroad show a distinct positive correlation between education level and wage level.

The achievements of Israeli pupils in international achievement tests are reasonable in comparison with most western countries. Thus, in the TIMSS and PIRLS tests of 2011, Israel was ranked in seventh place in mathematics, in thirteenth place in the sciences and in eighteenth place in reading among the countries tested. However, the main issue needing to be addressed was, and remains, the large gaps apparent between different sectors, between different regions of the country and between different population groups, which are among the highest in the world. It should be noted that in spite of the improvement in Israeli pupils' achievements in international achievement tests in recent years, the gaps remain unchanged.

According to Ministry of Education figures, some 50% of first-grade pupils in 2013 come from the Haredi and minorities sectors, with their proportion projected to increase over the years. As noted above, the processes of change in the pupil population composition have not been accompanied by processes ensuring equal opportunity and provision of the "toolkit" required for their future integration in the labor market.

Israeli schoolchildren's mediocre achievements, coupled with the gaps between population groups and the demographic trends, pose significant challenges to the education system, in terms of improving scholastic achievements and narrowing gaps while imparting the knowledge and skills required for integration in the labor market.

The government's awareness of these challenges is reflected in its budgetary priorities and in the structural changes proposed in the economic plan for 2013-2014.

The Ministry of Education will act in these years to strengthen studies of core subjects in the education system, by implementing several supplementary measures, among them the requirement that non-official recognized educational institutions and exempt institutions teach one-hundred percent of the core curriculum in the disciplines of mathematics, English and mother-tongue language, the requirement that educational institutions participate in the Meitzav exams (national standardized tests) and in international achievement tests, and the formulation of a program of enforcement, supervision and control of the implementation of these measures. These measures are expected to lead to an improvement in the education for work skills among the Haredi population, enabling better integration in the labor market and improved worker productivity.

Additions to the Ministry of Education's budget total NIS 7.9 billion cumulatively for 2013-2014, an increase of 22% over 2012 (discounting the addition to the Ministry of Education's construction budget).

Following are the major changes:

The Ministry of Education's budget proposal for 2013-2014 includes various additions mainly earmarked for the continued implementation of the "Ofek Hadash" ("New Horizon") and "Oz Letmura" ("Strength for Change") reforms in the education system, in an amount of NIS 1.9 billion in 2013 and an additional NIS 820 million in 2014; the provision of free schooling for the 3-4 age group, in an amount of NIS 1.2 billion in 2013 and an additional NIS 140 million in 2014; and the deployment of after-school enrichment frameworks for the three lowest socio-economic clusters, in an amount of NIS 600 million from 2013 and onwards.

These measures are aimed at reducing the scholastic gaps existing between pupils from different backgrounds. However, there is substantial evidence of a lack of correlation between amounts invested and educational results. Hence, the challenge facing the education system is an administrative one, including informed use of resources and the setting of priorities, which will lead to improved outputs and the meeting of targets defined by the Ministry of Education.

In view of the foregoing, besides the budgetary additions presented, the Education Ministry is promoting changes intended to create a supportive organizational basis for improving achievements, as described below:

Restructuring of administrative tools in the education system – In order to give a broader picture of the characteristics of the different schools in the system, particularly in terms of state-provided inputs to the schools, the Ministry of Education is currently setting up an integrated data system that will centralize data on inputs and outputs, including figures provided by the local authorities and various education ownerships. The ministry will also issue once a year, starting from the 2013/14 school year, a report presenting a summary of the allocation of resources from all public and private sources, within the education system.

Empowering the principal – The principals are school leaders that steer educational activity. Expanding the powers given to principals enables decision-making based on a closer familiarity with the pupil and his/her needs, resulting in an organizational infrastructure that supports scholastic achievements.

Expanding the registration districts – Studies have found that the controlled opening of registration districts leads to improvement in pupils' achievements. Researchers contend that controlled selection increases parental involvement, which also leads to improved scholastic achievements.

Higher Education

Human capital, in general, and higher education, in particular, have been a key advantage of the Israeli economy and its leading source of growth over the years. In view of the great importance of the higher education system for Israel, an agreement for a multi-year higher education plan was signed in October 2010 for the years 2010/11-2015/16. The plan provides additional resources for the higher education system, totaling NIS 7.5 billion over the six years of its implementation, which commenced in the 2010/2011 academic year.

During 2013-2014 implementation of the plan by the Planning and Budget Committee of the Council for Higher Education will continue, including by means of a budget supplement for the hiring and renewal of teaching staff, competitive research grants, physical development and development of scientific infrastructures, establishment of centers of excellence and implementation of plans for increasing higher education accessibility for the Haredi and Arab populations.

Development of Transportation and Mass Transit Infrastructures

Advanced transportation infrastructures are a vital component of economic growth and increased productivity, among other reasons because they are a necessary condition for a rapid, reliable and cheap connection between the different production facilities in the economy.

The government's transportation policy includes the allocation of resources for investment in the different kinds of transportation infrastructure, support for public transportation and policy steps for the regulation of the transportation sectors, and the creation of economic and competitive incentives in the vehicle, aviation, shipping and public transportation sectors. The main objectives underlying the transportation policy are:

- Developing advanced public transportation systems, such as light trains and bus rapid transit (BRT), and improving the public transportation network so as to increase accessibility and reduce congestion, pollution and accidents.

- Providing an appropriate solution for the increase in demand for trips, mainly by upgrading and widening existing urban and interurban roads.

- Improving efficiency in the allocation of road networks and vehicles, through the construction of public transportation lanes and expressways and enhancement of the economic incentives within the tax system.
- Bringing the periphery closer to the metropolitan centers by means of a system of expressways and trains.
- Encouraging competitiveness and removing barriers in aviation, the vehicle market, public transportation, shipping and seaports.

In recent years, government investments in transportation development have increased significantly, based on the perception that the provision of transportation services by the government as a public product is essential for sustaining economic growth.

Transportation budgets grew from NIS 10 billion in 2008 to NIS 14 billion in 2012, a trend that will be continued in the budget for 2013-2014. Below are the main areas of growth in the transportation budgets:

Investments in mass transit infrastructure – The budget for the development of mass transit systems (excluding Israel Railways and heavy trains) for 2013 and 2014 totals NIS 1.56 billion and NIS 2.70 billion respectively. The budget is mainly earmarked for planning mass transit systems in the metropolitan areas and for establishing the first mass transit lines in Jerusalem, in the Tel Aviv metropolis and in the Haifa metropolis. Mass transit systems such as the light rail, BRT systems and expressways are the most effective solution for contending with transportation challenges in metropolises.

During 2013-2014 implementation of the five-year public transportation plan in Jerusalem will continue. In this framework, the first light rail line will be extended to Hadassah and to Neve Yaacov and extensions will be added to Mt. Scopus and Givat Ram. Concurrently, planning will be advanced for two additional light rail lines in Jerusalem – the green line and the blue line, and preliminary plans will be developed for a mass transit system for all of Jerusalem. In the Haifa metropolis works are underway for the first BRT system, which will commence operating in August 2013, and additional mass transit lines are planned on the Carmel and between Haifa and Nazareth. In the Tel Aviv metropolis, NTA – Metropolitan Mass Transit System Ltd. is expected to complete preliminary work on the red line as well an organizational restructuring that will adapt the company for the execution of the project, and tenders are due to be issued for the execution of the construction works. In addition, in the Sharon region NTA will begin construction of a BRT system which is to link Kfar Saba, Raanana and Herzliya and another BRT system which will operate in Netanya.

Netivei Israel (Israel Routes) Plan – To enable implementation of its development goals for the Negev and the Galilee, the government decided in February 2010 on this NIS 27.5 billion plan. The plan includes the continued northward development of the Trans-Israel Highway in the direction of the Somekh Junction and construction of an express eastern branch from Yokne'am up to the Amiad Junction. The plan also includes the laying of railway tracks to Karmiel, Afula and Beit She'an, electrification of the national railway system, procurement of railroad rolling stock and extension of the Trans-Israel Highway southward, as well as advancement of the planning of other transportation projects.

Support for public transportation - The public transportation support budget for 2013 and 2014 amounts to NIS 4.9 billion and NIS 5.4 billion respectively. To increase the accessibility of employment, study and leisure centers to all citizens of Israel, the Ministry of Transport is continuing to expand the supply of public transportation services by bus and by train. Israel has 17 public transportation operators operating around 6,000 buses on 2,000 service lines reaching 30,000 stations countrywide. Israel Railways serves another 50 stations. In this sector, the state pays the operators several kinds of subsidies: general operating subsidy, appropriated subsidy for eligible populations groups, and a procurement subsidy. The number of paid passenger trips on public transportation in buses was estimated in 2011 at 601 million. In the first half of 2012 the number of paid passenger trips was estimated at NIS 310 million, representing an increase of 3.2%. The number of passenger trips on Israel Railways was estimated in 2012 at NIS 40 million, representing an increase of 4%.

R&D and Industry

The high-tech industry, as a growth leader, is a key sector of the Israeli economy, its importance being expressed, among other things, by its high contribution to the GDP, to the growth of the economy, including exports, to employment and to the attraction of foreign capital investments, and by its spillover effects on other sectors of the economy.

In 2011 high-tech industry exports accounted for 47% of total industrial exports. The number of employed in this industry in 2012 stood at 287,000, constituting 9.5% of total employed. The national research and development expenditure in Israel as a percent of GDP is the highest in the world, standing at 4.4% for 2011.

To continue supporting the development of Israel's high-tech industry, it was decided in the framework of the economic plan for 2013-2014 to improve the interfaces between this industry and the regulatory authorities in the life sciences sector and to strengthen economic ties with India, China and Brazil.

The plan for strengthening economic ties with China, India and Brazil includes the promotion of a plan for support in tailoring products for these markets and in the first experimental stages at the customer's site (beta site), as well as strengthening economic ties between companies from these countries and local companies in research and development and enhancing the professional tools of the Ministry of Economy's commercial attachés for the provision of assistance to Israeli companies that are taking their first steps in these countries.

Chapter 4 – Increasing Competitiveness and Reducing the Cost of Living

Communications Market

Landline Sector

In May 2012 the Minister of Communications issued a policy paper outlining a plan for the establishment of a wholesale market for landline communications, i.e. the wholesale supply of access segments by the Bezeq and HOT companies to competing operators, so that the latter can provide services to customers in general, and service packages in particular. Adoption of the wholesale market approach as a key component of the Ministry of Communications' policy, based on the recommendations of several public committees, is aimed at enabling additional players to penetrate the landline communications market, even without ownership of a nationwide broadband access infrastructure. This policy is necessary in today's market, in which only two companies operate and entry barriers are high due to the necessary investment in a nationwide infrastructure. The establishment of a wholesale market for landline communications infrastructure is needed to increase competition and enhance the public welfare and to motivate the owners of the landline broadband access infrastructure (Bezeq and Hot Telecom) to invest in the development and upgrading of infrastructures. In the framework of the plan for changing national priorities, it is proposed also to expand the powers of the Minister of Communications for the implementation of this policy.

The government also adopted a number of resolutions for the expansion of the broadband infrastructure supply by allowing a company partly owned by the Israel Electric Corp. Ltd. to offer FTTH (fiber-to-the-home) broadband infrastructure services, subject to a complete structural separation as well as other conditions, the principal ones being universal deployment and focusing of the company's activity on the provision of the fiber optic infrastructure to license holders who will provide the service to the end customers. The granting of approval to the Israel Electric Corp. to operate in the broadband infrastructure sector offers potential for the development of broadband infrastructure in Israel and for increased competition in this area.

Cell Phone Industry

During the past year competition in the cell phone industry has grown markedly, mainly due to the entry of two new cellular operators into the market, to the benefit of the consumer and the Israeli economy. The competition is reflected, among other things, in lower prices, product improvement and diversification and a substantial rise in migration between operators. In the coming year the Ministry of Communications will act in several ways to advance the industry technologically so as to make new advanced services available to the consumer. The ministry will also ensure the continued existence of the competition that developed in the past year between the players in the market of infrastructure-based mobile virtual network operators (MVNOs).

- **Tender for the allocation of frequencies for a fourth-generation broadband access network** – The purpose of the tender is to enable the development of a wide array of advanced high-quality high-speed communication services, this being an important public interest, in terms of advancing Israeli society economically and socially and facilitating Israel's integration in the information society and the western world. To this end, an inter-ministerial committee was set up, headed by the Ministry of Communications' Director General, for drawing up the tender terms and documents based on the principles of the policy for allocating broadband wireless access network frequencies.
- **Planning and construction** – The ministry will act to update the entire planning framework in the cell phone industry, in order to enable the deployment of fourth-generation networks and allow new competitors to complete the deployment of their new networks.
- **Interconnectivity rate** – The final step in the reduction of the cell phone interconnectivity rate will go into effect on January 1, 2014. The ministry will need to examine the interconnectivity costs and to decide whether to change the rate on cost basis or to change its policy and cancel the interconnectivity rate.

Television

The multichannel TV market in Israel is a duopoly of the cable and satellite companies, which enjoy a higher average revenue per subscriber than the average in the developed world. These higher revenue rates are a result of competition among a limited number of entities in the area of broadcasting platforms and the absence of competition in the area of added content (beyond the basic package).

Regarding the promotion of competition in the area of content (beyond the basic package), the ministry is working to compel the HOT and YES companies to offer their subscribers a narrow basic package, on a scope to be determined by the Minister of Communications and at a regulated price. A narrow package will give independent content providers a retail margin allowing for economic feasibility, prevent the cable and satellite companies from blocking competition in the area of content through the subsidization of prices by means of the basic packages and provide light-content consumers with a cheap, quality alternative.

Amendment of the Digital Broadcasting Law

The availability of as wide as possible an array of channels has a decisive impact on competition in the communications industry and on the level of prices paid by the consumer. Ongoing technological developments and the possibility of transmitting television broadcasts on the Internet confer increasing importance on the DTT (digital terrestrial television) system as a complementary product to Internet products that at present have difficulty in enabling linear transmission of content on the existing Internet network. There are channels on diverse subjects that are unable to finance their activity solely by means of advertising broadcasts, as permitted by the law in its current version. Therefore, in order to enable the existence of these broadcasts on the network, it is proposed in the framework of the Law for Changing National Priorities to allow any channel to collect payment for viewing of its broadcasts.

Implementation of the Food Committee's Recommendations

The Committee to Examine Competitiveness and Prices in the Food and Consumer Goods Market was established in July 2011 for the purpose of studying the characteristics of the food and consumer goods market, identify market failures (if any) and formulate recommendations for improving consumer welfare. The committee found that there is a high level of concentration in the food market, both in the productive segment and in the retail segment, and that the market suffers from anti-competitive practices that have led over the past decade to reduced competition and to higher price increases than around the world. With a view to dealing with these failures, the committee recommended a series of steps intended to increase competition in the food market and reduce food prices:

- **Price transparency** – The retail chains will be obligated to publish in a public database the prices of all products in all the chain's branches, in real time, in a comparable digital format, to enable the development of applications and websites for comparing prices based on such databases.

- **Regulation of relations between suppliers and retailers** – Tools will be provided to the Antitrust Authority for enforcing prohibitions on anti-competitive behavior in the food market, such as the arrangement of shelves by the large manufacturers so as to edge out smaller manufacturer, interference in prices and in quantities sold by competing manufacturers, etc. These regulatory measures are intended to prevent abuse of the market power of large manufacturers and the edging out of smaller manufacturers from the food retail chains.

- **Model for increasing regional competition –** Competitiveness in the food industry varies from one region to another. An empirical examination of food prices in Israel found that the higher the concentration in a sales region, the higher the consumer retail price. Likewise, it was found that the retail chains employ a tactic of "seizing" shelf space in order to deny space to potential competitors. The Antitrust Authority will examine the level of regional competition in the food industry and prohibit the seizure of commercial areas in order to edge out competitors.

Improvement of National Standards Policy

In Israel there are hundreds of official standards whose main purpose is to safeguard public health and protect the environment. However, ineffective use of the standards and of the system of standard tests could present a barrier and cause harm to dealers and consumers in the market. It is proposed to advance legislative amendments for the institution of the following changes in the national standards policy:

- **Adoption of international standards –** At present there are more than 600 official standards in Israel. It is proposed to adopt only international standards, for increased harmonization of standards between Israel and other developed countries, thereby reducing import barriers arising from differences in standards.

- **Switch to a method of reliance on a manufacturer's or importer's declaration** – It is proposed to make due with a manufacturer's or importer's declaration of compliance with the conditions of the relevant standard, with respect to products that do not pose a significant safety or health risk (e.g.: carpets), while increasing enforcement in the markets and at the ports and maintaining the authority of the Standards Commissioner at the Ministry of Economy to require a laboratory test where necessary.

In addition, with a view to improving decision-making with respect to the imposition of trade duties, it is proposed to determine that the Trade Duties Commissioner at the Ministry of Economy be required to prepare a broad and established database as a basis for reaching decisions on the subject.

Chapter 5 – Increasing Public-Sector Efficiency

Water Economy

Increasing Distribution Efficiency in the Municipal Water and Sewage Economy

In accordance with the provisions of the Water and Sewage Corporations Law, the local authorities are required to manage the water and sewage economy within their jurisdiction through water and sewage corporations. This duty applies since July 2007. As of today, there are 55 water and sewage corporations serving some six million residents. The establishment of the water and sewage corporations was intended to solve the structural failings in the municipal water economy, which included a serious investment deficiency mainly due to use of the monies that were collected for water for other municipal needs. The water and sewage corporations manage the municipal water and sewage economy as a closed monetary economy, ensuring that all revenues in respect of water consumption are used for the required investments in the water and sewage economy.

Due to the serious water crisis affecting Israel and the urgent need to remove the management of the municipal water and sewage economy from the hands of the local authorities and transfer it to the water and sewage corporations, in the initial stage too many corporations were set up.

Accordingly, it is proposed to amend the Water and Sewage Corporations Law to enable the Government Water and Sewage Authority Council to issue directives for the establishment of regional companies instead of the water and sewage corporations. The professionals at the Water Authority believe that the establishment of such regional companies will result in a significant savings in operating costs. Therefore, it is proposed to reduce the corporations' recognized operating norm, so as to subsume the savings resulting from the reduction in the number of corporations, leading to an estimated 5% reduction in water tariffs. According to the amendment to the law, existing water and sewage corporations will be able to receive an exemption from merging into a regional company, if they are able, within the framework of the new operating norm, to satisfy the following parameters: compliance with an investment plan, financial stability and meeting of consumer service criteria. Compliance with these parameters will be examined every year starting from 2015.

Regulation of the Rural Zone within the Water and Sewage Economy

In the rural zone (local authorities) there is no requirement to establish a water corporation, and the water tariffs as determined by the Government Water Authority Council are non-cost-basis maximum tariffs. As a result, there are concerns that the water infrastructures in the rural zone are in a state of continual under-investment. In light of the foregoing, it is proposed to direct the Water Authority Council to determine that the water and sewage tariffs for domestic users in the rural zone will be cost-based, taking into account the required investments in water and sewage infrastructure in the rural zone. In addition, it is proposed to direct the Government Water Authority Council to act to regulate the treated wastewater economy.

In the past decade the treated wastewater economy has become a central part of water resource management and the allocation of water for agriculture. In addition, the treated wastewater economy has a significant impact on the sewage system from many aspects, among them regulatory, planning, sanitary, economic and environmental aspects. The rate of treated wastewater recovery in Israel stands at 90%, mostly for agricultural use. This recovery rate is the highest in the world. In 2011 a total of 400 million cubic meters of treated wastewater were supplied, accounting for 38% of all water supplied for agriculture and 20% of the total water supply for all uses. Recovery is done by means of plants that are responsible for the collection of the water discharged from wastewater treatment plants and its conveyance to the consumers.

The rapid development of the treated wastewater economy, mainly based on private entrepreneurship, which occurred against the background of a serious water crisis, was not accompanied by promotion of the regulatory measures needed for the regulation of the economy.

Hence, so as to achieve better management of the treated wastewater economy, including a more effective and equitable allocation of resources in the economy, it is proposed to direct the Water Authority Council to act to reduce the number of treated wastewater providers, to set tariffs for treated wastewater providers that ensure an adequate investment in infrastructure over the coming years, and to safeguard the consumer's welfare by maintaining a price level that will not allow private entrepreneurs to make an unreasonable profit.

Additional Measures for Increasing Public-Sector Efficiency

Other public services in which it is proposed to make changes in order to improve the service to the public include religious services, public transportation, environmental protection, education, health and the defense industries.

Budget Proposal for Fiscal Years 2013-2014

Expenditure Frameworks

- The gross state budget proposal for fiscal years 2013-2014, including the revenue-dependent expenditure, totals NIS 416.9 billion in fiscal year 2013 and NIS 428.7 billion in fiscal year 2014.
- The budgetary expenditure for calculating the expenditure limit in fiscal years 2013-2014 stands at NIS 309.5 billion in fiscal year 2013 (including one-time expenditures) and at NIS 320.3 billion in fiscal year 2014.
- The budgetary expenditure for 2013, as defined for calculating the expenditure limit (including one-time expenditures), is 7% higher in real terms than the budgetary expenditure for calculating the expenditure limit for 2012. Said real growth consists of an increase of NIS 9.5 billion as a derivative of the total expenditure, an addition of NIS 3.8 billion due to adjustment of the budget to 2012 prices, and a one-time addition of NIS 6.5 billion.
- The budgetary expenditure for 2014, as defined for calculating the expenditure limit, is 3.35% higher in real terms than the budgetary expenditure for calculating the expenditure limit for 2013 (net of one-time expenditures).

Changes in the Budget Proposal

The budgetary expenditure for calculating the expenditure limit grew in 2013 and 2014 by nominal 8.7% and 3.5% respectively (the sum for 2013 includes a one-time expenditure). Net of the one-time amount, the budget for calculating the expenditure limit in 2014 grew by 5.7%. In accordance with the government's policy, the main increases in the state budget for 2013-2014 are in the areas of schooling, higher education, health, infrastructure and maintaining public order.

These increases, as prioritized by the government, are enabled due to the decrease in the public debt and in the government deficit as a percent of GDP (this decrease moderated the expenditures on interest payments), and also due to government decisions to implement significant cuts, mainly in the defense budget and in the transfer payments.

Below are the main changes in the budget proposal for fiscal years 2013-2014 relative to the previous year:

- Civil expenditure for fiscal year 2013 will increase by 14.% relative to the Budget Law for 2012. In fiscal year 2014 the civil expenditure will increase by 4.3% relative to the budget proposal for fiscal year 2013. These budget increases are considerably higher than the increase in the budgetary expenditure for calculating the expenditure limit in 2013-2014, and they derive primarily from increased wage payments across the entire public sector and particularly in the education system and in the health system.

- Defense expenditure for fiscal year 2013 will increase by 5.2% relative to the Budget Law for 2012. In fiscal year 2014 defense expenditure will decrease by 1.3% relative to the budget proposal for fiscal year 2013. The decrease in defense expenditure in 2014 is a result of the government's decision to cut NIS 3 billion from the defense budget for that year. In addition, U.S. military grants were supposed to increase between 2012 and 2013 by USD 25 million and were expected to stand, from 2013 and onwards, at USD 3.1 billion. However, following the U.S. federal budget sequestration that went into effect on March 1, military aid for 2013 was reduced by USD 157 million.

- Transfer and support payments will increase in fiscal year 2013 by 9.1% relative to the Budget Law for 2012. In fiscal year 2014 transfer and support payments will increase by 2.4% relative to the budget proposal for 2013. The growth in transfer and support payments in fiscal years 2013-2014 stems mainly from the government's policy of incorporating new technologies and medications in the health services basket, increasing the budget transferred to the business sector and raising the subsidies transferred to public transportation. However, this increase was moderated by the government's decision to cut NIS 2.9 billion from National Insurance transfers for child allowances in 2014.

- Investments and credit granted will increase in fiscal year 2013 by 20% relative to the Budget Law for 2012. In fiscal year 2014 investments and credit granted will increase by 9.6% relative to the budget proposal for fiscal year 2013. These budget increases are significantly higher than the increase in the budgetary expenditure for calculating the expenditure limit in 2013-2014. The growth in investments and credit granted in fiscal years 2013-2014 stems mainly from government decisions to increase expenditures on transportation infrastructure, including accelerated development of public transportation infrastructures and mass transit systems.

- Interest payments will increase in fiscal year 2013 by 2.3% relative to the Budget Law for 2012. In fiscal year 2014 interest payments will increase by 5.8% relative to the budget proposal for 2013. These increases are mainly due to the increase in the budget deficit and the uncertainty prevailing in the markets.
- Principal payments (loan principal repayments), excluding principal repayments to the National Insurance Institute, will increase in fiscal year 2013 by 5.2% relative to the Budget Law for 2012. In fiscal year 2014 principal payments, excluding principal repayments to the National Insurance Institute, will increase by 0.6% relative to the budget proposal for 2013. The changes in principal payments are an outcome of the structure of the debt amortization schedules. These payments are not included in the calculation of the deficit and in the calculation of the permitted expenditure under the Deficit Reduction and Budgetary Expenditure Limitation Law, 1992.

Gross Expenditure by Economic Classification

(In NIS thousands)

		2012 Original Budget	2012 Budget Performance	2013 Budget Proposal	2014 Budget Proposal
Net expenditure		**365,916,172**	**376,391,794**	**395,032,948**	**406,264,956**
Revenue-dependent expenditure		19,072,349	19,171,126	21,860,357	22,440,677
Total gross budget (1+2)		**384,988,521**	**395,562,920**	**416,893,305**	**428,705,633**
1.	**Total expenditures and credit granted**	**303,729,521**	**307,179,259**	**331,404,305**	**342,702,633**
1.1	Civilian consumption	70,301,871	71,154,556	80,690,728	84,156,857
	Domestic payroll	44,111,014	46,632,387	49,997,784	52,979,768
	Domestic procurement	24,054,815	22,013,648	28,394,971	28,809,343
	Overseas payroll and procurement	2,136,042	2,508,521	2,297,973	2,367,746
1.2	Defense consumption	55,726,109	66,609,801	58,622,232	57,839,673
	Payroll	23,066,345	23,372,581	25,265,092	27,569,867
	Transfer payments	2,256,393	2,440,916	2,501,156	2,574,286
	Procurement	19,114,180	27,230,367	19,721,081	17,126,705
	Construction	1,005,405	3,641,892	955,135	0
	Overseas procurement	9,777,213	9,353,061	9,496,216	10,055,266
	Emergency expenditures and coordination of operations in the territories	506,573	570,984	683,552	513,549
1.3	Transfer and support payments	101,288,031	102,735,528	110,504,521	113,114,103
	Transfers to payroll for teachers and higher education	15,691,529	18,032,804	19,377,203	19,697,382
	Transfers to National Insurance Institute	31,081,497	30,248,395	31,576,055	30,740,413
	Transfers to health system	18,378,801	17,246,203	19,704,647	20,570,920
	Miscellaneous transfers and supports	31,273,667	31,613,600	31,584,042	34,008,388
	Subsidies of basic commodities and production means	4,862,537	5,594,526	8,262,575	8,097,000
1.4	Investments and credit granted	20,982,781	19,334,728	25,158,623	27,569,343
	Direct investment	18,309,547	18,120,321	23,215,542	25,539,123
	Credit granted	2,673,234	1,214,407	1,943,081	2,030,220

Gross Expenditure by Economic Classification (cont.)

		2012 Original Budget	2012 Budget Performance	2013 Budget Proposal	2014 Budget Proposal
1.5	Interest payments and credit subsidies	38,577,176	38,049,292	39,472,788	41,762,276
	Domestic interest payments	31,673,000	32,176,402	33,056,000	34,722,000
	Credit subsidies	7,176	0	13,788	17,276
	Overseas interest payments	6,897,000	5,872,890	6,403,000	7,023,000
1.6	Miscellaneous expenses	9,097,000	9,295,354	9,879,000	10,859,000
	Principal repayment to National Insurance	9,097,000	9,295,354	9,879,000	10,859,000
	Miscellaneous	0	0	0	0
1.7	Reserves	7,756,553	0	7,076,413	7,401,381
2.	**Debt repayment – principal**	**81,259,000**	**88,383,661**	**85,489,000**	**86,003,000**
	Domestic debt repayment	72,601,000	75,584,685	74,084,000	74,727,000
	Overseas debt repayment	8,658,000	12,798,976	11,405,000	11,276,000

* Due to changes in the economic classifications, in the framework of the "Harish Amok" ("Deep Furrow") plan, there may be inconsistencies in the definitions in the transition from 2012 to 2013.

Analysis of Budget Proposal Development in Fiscal Years 2005-2014

The section presents an analysis of the budgetary expenditure development between the years 2005-2014 according to main areas, such as defense and public order, education, health, etc. The analysis is presented in two ways: The first shows the real change in each of the areas over time, while the second shows the change in the distribution of the budgetary expenditure, that is, the change in the share of each area out of the total budgetary expenditure. One can see from this comparison which areas of expenditure increased their relative proportion in the budgetary expenditure over the period and which areas of expenditure contracted and freed up funds within the budgetary framework. These changes in the budgetary distribution can stem from changes in priorities, but also from the creation of extra-budgetary mechanisms as well as internal dynamics within the budget that lead to different behavior of each expenditure component. An example of such a dynamic is the development of the expenditure on interest. Thus, for example, if the total government debt remains unchanged, but the interest rate at the time of the debt funding decreases, the expenditure on interest decreases, with a resulting decline in the share of this expenditure out of the total expenditure.

Although the budgetary expenditure represents the substance of the government's budgetary policy, there are other operations and expenditures which are funded by the public that are not fully reflected in the budget itself. Therefore, in order to gain a complete picture of the development of the government expenditure, these too must be taken into account. The most notable expenditures in this context are the expenditures of the National Insurance Institute and the expenditure on the health basket, which will be discussed in the analysis of the areas of expenditure. Other operations of the government which are not fully reflected in the budgetary expenditure are discussed in brief at the end of the chapter.

Development of Budgetary Expenditure by Main Areas of Operation

Between 2005-2014 the total budgetary expenditure (excluding revenue-dependent expenditures) grew by 19% in real terms, a real average annual increase of 2.0%. As a result of the decrease in the proportion of the expenditure on interest in the total budget, due to relatively low government debt growth and lower interest rates on the debt, the total budgetary expenditure net of interest expenses grew in these years by 24.5% (2.5% real average annual increase).

The main areas of expenditure in the budget proposal for 2013-2014 are defense and public order (accounting for 24% of the budget), schooling and higher education (17%), welfare and social security (13%) and interest payments (13%).

The main areas of expenditure whose proportion in the total budgetary expenditure grew over these years are: schooling and higher education, on which the expenditure rose at a real average annual rate of 4.0% (causing the share of this expenditure to increase by 2.7 percentage points), health, on which the expenditure rose at a real average annual rate of 2.9((increase of 0.6 percentage points), and transportation, on which the expenditure rose at a real average annual rate of 6.4% (increase of 1.8 percentage points), mainly due to large additions in the years 2012-2014. The main area of expenditure in which a decrease was recorded is interest payments, which decreased at a real average annual rate of 0.8%, as a result of which its proportion in the budget contracted significantly (decrease of 3.7 percentage points). This fact underscores the importance of maintaining a responsible fiscal policy and illustrates how such a policy frees up funding within the budget framework for expanding public services on account of interest payments.

It should be noted that the calculations presented in this section are based on the net expenditure, and therefore they do not take into account the expenditures of the different ministries which are dependent on earmarked revenues. Thus, for example, in recent years the increase in U.S. military aid was recorded as a revenue-dependent expenditure, and therefore the overall increase in the defense expenditure is greater than the increase appearing under the net expenditure.

Net Budgetary Expenditure, 2005-2014, and Distribution by Main Areas of Expenditure

Original Budget, NIS Billions, at Current Prices

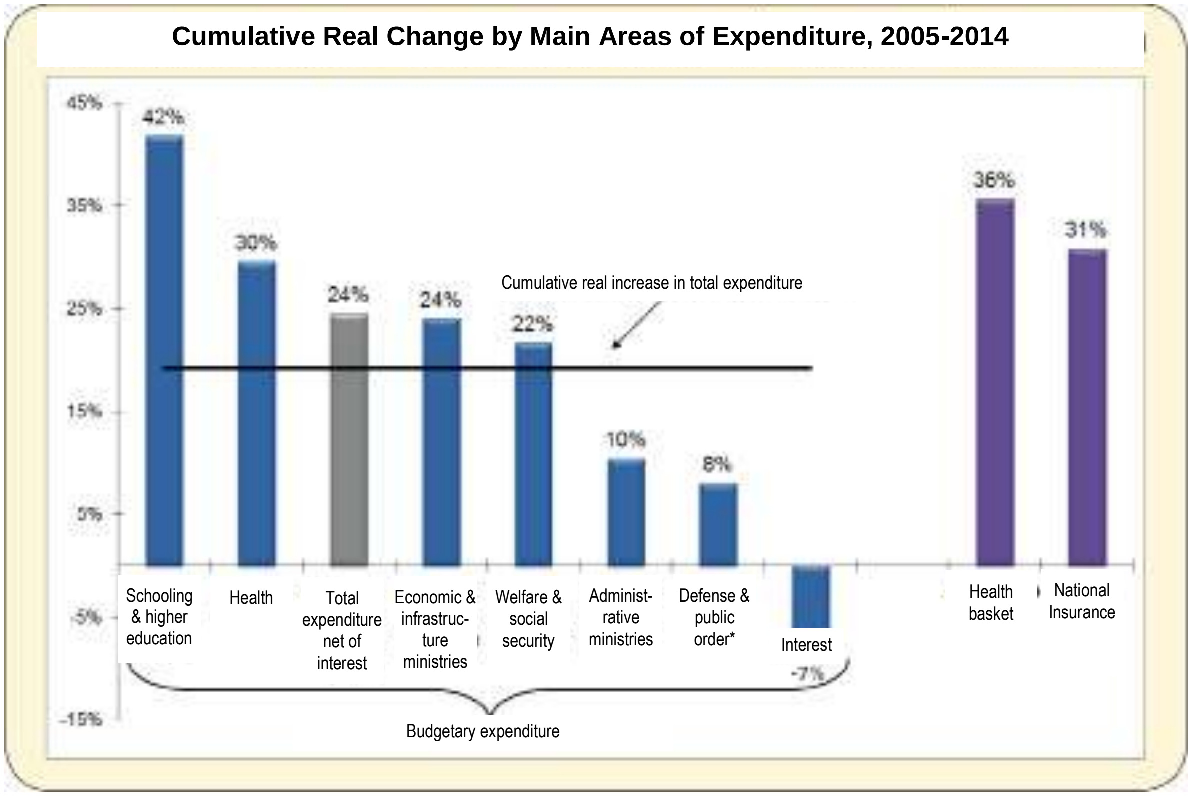
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Change in Percentage Points between 2005 and 2014	Cumulative Change in Real Terms*
Total expenditure	215.5	219.0	230.0	235.7	248.2	256.0	271.2	284.7	309.5	320.3		19%
Distribution of main areas of expenditure out of the budgetary expenditure												
Defense and public order	25.5%	25.2%	26.9%	26.6%	24.7%	25.7%	24.9%	24.3%	24.0%	23.1%	-2.4%	8%
Schooling and higher education	14.5%	14.7%	14.1%	14.5%	15.0%	15.6%	15.8%	15.6%	16.9%	17.2%	2.7%	42%
Welfare and social security	12.6%	12.9%	12.9%	13.8%	14.4%	13.7%	14.2%	14.0%	13.4%	12.9%	0.3%	22%
Economic and infrastructure ministries	9.9%	9.6%	9.1%	8.9%	9.3%	8.9%	9.0%	9.1%	9.9%	10.3%	0.4%	24%
Health	6.9%	7.0%	7.1%	6.6%	6.6%	7.2%	7.4%	7.4%	7.5%	7.5%	0.6%	30%
Administrative ministries	4.3%	4.6%	4.6%	4.8%	3.9%	4.1%	4.3%	4.2%	4.3%	3.9%	-0.3%	10%
Interest	16.7%	16.2%	15.4%	14.6%	14.4%	14.8%	13.6%	13.5%	12.7%	13.0%	-3.7%	-7%
Other expenditures**	9.6%	9.8%	9.8%	10.2%	11.7%	9.9%	10.8%	11.9%	11.4%	12.0%	2.4%	49%
Total expenditure net of interest	179.4	183.5	194.5	201.1	212.6	218.0	234.4	246.1	270.1	278.5		16%

* The real change is calculated on basis of the change in the consumer price index, including forecasts for the coming years.

** The main components in the other expenditures item are state civil pension payments, the pension funds arrangement and principal repayments to the National Insurance Institute.

Note: The data are presented according to the original budget submitted to the Knesset. In practice, budgetary items may change due to alterations in the Knesset, the carrying of surpluses from year to year, urgent needs which arise in the course of the year, etc. An example of an expenditure that undergoes relatively frequent changes is the defense expenditure. Therefore, the distribution of the actual expenditure in each year in the different areas is likely to be somewhat different than what is shown in the table. Nevertheless, the cumulative changes reflect to a reasonable extent the developments over time, and as an outcome also the budgetary priorities. Furthermore, to maintain consistency, all the real changes are calculated according to the consumer price index. In practice, in order to carry out a complete analysis of the quantitative change in each area, it is necessary to use various indices. For a specific analysis of the individual areas of expenditure, see the budget proposal booklets of the different government ministries.

Between 2005 and 2014 National Insurance Institute expenditures (excluding operating expenses and reserve duty payments) increased at a real cumulative rate of 31%, equivalent to an annual rate of 3.0% – a much higher rate than the rate of increase in the budgetary expenditure, which stood in this period, as stated, at 2.0%. The expenditure on the health basket, which, too, as noted, is not fully reflected in the budgetary expenditure, grew rapidly in this period at a real annual rate of 3.5%.



* Excluding the budgetary addition arising from the increase in U.S. military aid. Also excluding additions granted in the course of the year, which could have a significant effect on the defense expenditure in which there is a large variance.

Other Government Activities Not Reflected in the Budgetary Expenditure

A significant area that does not appear directly in the budgetary expenditure, but which must be taken into account in an analysis of the budget policy and budgetary priorities, is tax benefits. Tax benefits are in sorts a "subsidy," and therefore they should be treated, when setting economic policy and budgetary priorities, as any other budgetary expenditure. Many of the tax benefits are embodied in assistance to industry and employment, for example through the Encouragement of Capital Investments Law or through various tax credits that increase the net wage, affecting work incentives and reducing employers' payroll expenses (for a broader discussion of tax benefits, see the chapter on state revenues from taxes).

Other relevant operations are the local government budget which is funded from authorities' direct revenues, public-private partnership projects that affect the total public investment although they do not appear fully in the budgetary expenditure, and guarantees granted to various bodies that constitute a subsidy for their operations. Additional investments made outside the framework of the state budget are investments financed directly by the public, such as investments in the electricity and water economy, which are financed fully or partially through the product tariffs.

State Deficit and Deficit Financing in Fiscal Years 2013-2014

Expenditures and Revenues for the Deficit Calculation

- The budgetary expenditure for calculating the expenditure limit stands at NIS 309.0 billion in fiscal year 2013 and at NIS 319.6 billion in fiscal year 2014.
- The forecast of revenues and grants for the years 2013-2014 stands at NIS 263.4 billion in fiscal year 2013 and at NIS 288.5 billion in fiscal year 2014.

Details of the forecast of state revenues from taxes appear in this booklet in the section on state revenues from taxes for 2013-2014.

State Budget Deficit

The overall deficit excluding credit in 2013 is expected to amount to NIS 45.6 billion, equivalent to 4.65% of GDP, based on assumed growth of 3.8% (the forecast GDP for 2013 is NIS 981.7 billion).

The overall deficit including net credit in 2013 is expected to amount to NIS 41.2 billion, equivalent to 4.2% of GDP.

The overall deficit excluding credit in 2014 is expected to amount to NIS 31.1 billion, equivalent to 3.0% of GDP, based on assumed growth of 3.3% (the forecast GDP for 2014 is NIS 1,037.8 billion).

The overall deficit including net credit in 2014 is expected to amount to NIS 26.9 billion, equivalent to 2.6% of GDP.

Overall Deficit Financing in Fiscal Years 2013-2014
(In NIS billions)

Deficit Financing Sources	2013 Total	2014 Total
Revenues from sales of land	1.1	1.1
Loans from abroad (net)	0.4	-1.5
Loans from the public (net)	39.7	27.3
Total	**41.2**	**26.9**

Note: Substitution is possible among the various deficit financing components.

Budget Deficit and Financing
(In NIS thousands)

	2012 Original Budget	2012 Budget Performance	2013 Budget Proposal	2014 Budget Proposal
Part I: Deficit				
Surplus (+) / deficit (-) excluding credit	-18,290,486	-38,981,856	-45,650,360	-31,139,072
Required adjustments to cash basis*		1,598,631		
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Total revenues excluding principal collection	265,093,452	246,870,688	263,350,507	288,492,664
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Income and property taxes	111,800,000	107,218,351	112,800,000	126,300,000
Customs and VAT excluding VAT on defense imports	114,800,000	105,424,014	116,000,000	125,300,000
Fees	5,700,000	5,447,660	5,700,000	6,000,000
VAT on defense imports	1,526,297	1,190,104	1,452,676	1,566,155
Debt collection – interest	2,230,900	1,398,566	1,358,749	1,358,190
Loan from National Insurance Institute	15,835,000	13,950,000	14,564,000	16,247,000
Grants	8,672,174	8,871,730	8,745,795	8,632,316
Other revenues	4,529,081	3,370,263	2,729,287	3,089,003
Total expenditures excluding credit granted	283,383,938	287,451,175	309,000,867	319,631,736
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Administrative ministries	39,002,730	40,216,712	42,550,084	44,740,469
Social ministries	109,380,205	112,886,423	120,479,436	123,688,558
Economic ministries	20,121,005	20,666,221	27,066,778	29,431,766
Defense	52,550,801	62,417,805	55,057,180	53,631,683
Miscellaneous expenses	6,905,644	3,919,908	7,432,975	8,133,879
General reserve	7,756,553	0	7,076,413	7,401,381
Principal and interest payments to National Insurance Institute	47,667,000	47,344,646	49,338,000	52,604,000
Net credit	-1,273,234	-556,958	-543,081	-630,220
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Credit repayments	6,058,900	5,304,978	5,009,718	4,832,806
Part II: Financing				
Total loans from abroad – net**	342,000	-1,330,966	395,000	-1,476,000
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Loans received	9,000,000	11,468,010	11,800,000	9,800,000
Debt repayments	-8,658,000	-12,798,976	-11,405,000	-11,276,000
Total domestic loans – net	11,349,820	37,729,563	39,656,725	27,280,488
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Loans received	83,950,820	113,314,248	113,740,725	102,007,488
Debt repayments	-72,601,000	-75,584,685	-74,084,000	-74,727,000
Total capital revenues	1,813,000	809,248	1,132,000	1,132,000
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Privatization	1,813,000	809,248	1,132,000	1,132,000

* Adjustments required to present the government deficit on cash basis according to changes in the cash balances at the Bank of Israel.

** Substitution is possible among the various components of deficit financing.